***United States Court of Appeals***

***for the***

***District of Columbia Circuit***

# TRANSCRIPT OF RECORD

BRIEF FOR PETITIONER AND JOINT APPENDIX

359

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

DISTRICT OF COLUMBIA, )
Petitioner, )
v. ) No. 17,352
HYMAN GOLDMAN, et al., )
Respondents. )

HYMAN GOLDMAN, et al., )
Petitioners, )
v. ) No. 17,354
DISTRICT OF COLUMBIA, )
Respondent. )

ON PETITION FOR REVIEW OF DECISIONS OF
THE DISTRICT OF COLUMBIA TAX COURT



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## QUESTION PRESENTED

Where respondents received from corporations in which they were stockholders distributions in cash in excess of the earned surplus of the corporations, without any redemption of their stock interests, or liquidation or dissolution of the corporations, the question presented is:

Was it not error for the District of Columbia Tax Court to hold that these distributions were not includible in the gross income of respondents as defined by the District of Columbia Income and Franchise Tax Act of 1947,as amended?

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## Subject Index



## CASES CITED

CASES chiefly relied upon are marked by asterisks.

## STATUTES CITED

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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Nos. 17,352 & 17,354

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DISTRICT OF COLUMBIA,

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## BRIEF FOR PETITIONER

## JURISDICTIONAL STATEMENT

This is a proceeding to review decisions of the District of Columbia Tax Court, based upon its findings of fact and conclusions of law, which declared partially erroneous assessments made by the District of Columbia against respondents for the calendar year 1959, and in Docket Numbers 1762 and 1763 also declared partially erroneous assessments made for the

calendar year 1960. (J.A. 55-72). The decisions of the Tax Court were entered on June 26, 1962. A petition for review of these decisions was filed by petitioner on July 26, 1962. (J.A. 73).

The jurisdiction of this Court is invoked pursuant to the provisions of Section 1, Title XV, Article I of the Act of July 16, 1947, 61 Stat. 328, ch. 258 (Section 47-1593, D. C. Code, 1961) and Sections 3 and 4, Title IX of the Act of August 17, 1937, 50 Stat. 673, ch. 690, as added by Section 8 of the Act of May 16, 1938, 52 Stat. 371, ch. 223; and as amended by Section 5 of the Act of July 26, 1939, 53 Stat. 1108, ch. 367, as amended by Section 3 of the Act of July 10, 1952, 66 Stat. 543, ch. 649 (Sections 47-2403 and 47-2404, D.C. Code, 1961).

## STATEMENT OF THE CASE

These cases involve assessments of District of Columbia individual income taxes for the years 1959 and 1960. Specifically, they involve assessments of District income taxes against stockholders of four corporations - The Berkshire, Inc., Queenstown Apartments, Section A., Inc., Queenstown Apartments, Section B, Inc., and Queenstown Apartments, Section E., Inc. The assessments which form the basis of the District's appeal are for income taxes on distributions made from "depreciation reserves" of these four corporations. The District of Columbia Tax Court found that the distributions from the "depreciation reserves" of these four corporations were in the nature of a return of capital to the stockholders and, as such, were not subject to District income taxes.

For purposes of clarity, The Berkshire, Inc., hereinafter referred to as "The Berkshire," and the three Queenstown Apartment corporations, hereinafter referred to as "Queenstown A," "Queenstown B," and "Queenstown E," will be discussed separately.

## I

## The Berkshire, Inc.

The Berkshire is a corporation owning a large apartment building located in the District of Columbia. (J. A. 17). The building was completed in 1951 and has been successfully operated since that time. At some date prior to the taxable years involved the corporation redeemed preferred stock in the amount of $243,500, and paid off ordinary loans of approximately $250,000. By the end of 1960 it had reduced the mortgage indebtedness on the building by $1,224,643.04. (J. A. 17).

During the taxable years involved the capitalization of the corporation consisted of 100 shares of preferred stock with a par value of $1 per share, or a total par value of $100, which stock was held by the United States under its loan agreement with the corporation, and 500 shares of common stock with a par value of $1 per share, or a total of $500 for all common stock. (J. A. 17).

The books of account of each of the corporations contained a "depreciation reserve" account which represented or was intended to represent the accumulation over the years of the amounts of depreciation

deduction or allowances. (J.A. 19). With the exception of a small reserve fund deposited with the mortgagee as a deposit for insurance and various other items, no fund was actually established by the Berkshire to provide for depreciation. (J.A. 19).

During the calendar years, 1958 and 1959, respondents, as common stockholders of the corporation, received cash distributions from the corporations. A breakdown of what the stockholders received and what they reported on their District tax returns is set forth in the findings of fact of the Tax Court. (J.A. 19-23). These distributions represent amounts made from profits or earnings of the corporation which the stockholders stated were taxable, and amounts from the so-called "depreciation reserve" which the stockholders contended were not subject to District income tax. The District assessed a deficiency in income taxes on the amounts received by the stockholders from the so-called "depreciation reserve" and these assessments formed the basis of the cases brought by the stockholders in the Tax Court.

In its opinion the Tax Court held that a corporation cannot distribute to its stockholders funds out of "depreciation reserves" as long as it has accumulated earnings and profits. (J.A. 33). On this basis, the court held that the Berkshire had accumulated net earnings which were sufficient to cover distributions made to the stockholders in the taxable year 1958.

The deficiency assessments made against the stockholders for the year 1958 were, therefore, held by the Tax Court to be valid. (J.A. 37, 40).

For the taxable year 1959, the Tax Court held that accumulated net earnings carried forward, and net earnings by the corporation in 1959, plus a tax refund, in the total amount of $80,955.07 were available for distribution as a dividend to the stockholders and taxable as such. The difference between $80,955.07 and $120,005, the total distributed in that year, i.e. $39,049.93, was held by the Tax Court to have been made out of a "reserve for depreciation" and, therefore, not to be taxable since it represented a return of capital. (J.A. 37, 40).

The court held that net earnings for the year 1960 were available for distribution as dividends and taxable, but that the distributions in excess of net earnings which the stockholders received in 1960, namely $237,681.11, were from "depreciation reserves" and, as "capital distribution," were non-taxable (J.A. 37-38, 40-41).

II

Queenstown Apartments

The Queenstown Apartment's distributions involve the same principle as the distributions made by the Berkshire. With the exception of respondents David L. Blanken and Edna R. Blanken, who sought adjudication from the Tax Court on the taxability of distributions made to them during 1960, the

only taxable year involved is the fiscal year which ended September 30, 1959. (J.A. 23-24).

The capitalization of each of the Queenstown corporations consisted of 100 shares of preferred stock of a par value of $1 each, or a total par value of $100, held by the mortgagee under a loan agreement, and 1,500 shares of common stock of the par value of $1 each, or a total for all shares of common stock for each corporation of $1,500. (J.A. 24).

The common stockholders of each of the Queenstown corporations reported taxable income for 1959 to the extent of distributions claimed to be out of earnings or profits of the corporation. However, the stockholders contended that distributions reported by them as made from "depreciation reserves" were a return to them of capital and, consequently, such distributions were not subject to District income tax.

The Tax Court held that, during the fiscal year ending September 30, 1959, Queenstown "A" had accumulated earnings and profits sufficient to cover distributions to its stockholders during 1959 and, therefore, the entire amount of these distributions was, as to respondents, subject to District income tax. (J.A. 53).

As to Queenstown "B", the Tax Court held that it distributed to respondents $1,450.98 in excess of available earnings in 1959, and, consequently, held that this amount was nontaxable because it was a distribution out of "depreciation reserves." (J.A. 53, 54).

The Tax Court further held that Queenstown "E" distributed to respondents $460.42 in excess of available earnings in 1959, and that this amount was also nontaxable as a return of capital out of "depreciation reserves." (J.A. 53, 54).

The Tax Court determined that distributions to the stockholders of the several Queenstown corporations in 1960 were made after they had discontinued business, that the distributions were from reserve funds deposited with mortgagees, and that these distributions were capital distributions and non-taxable. (J.A. 54).

The decisions of the District Tax Court were entered on June 26, 1962. (J.A. 55-72).

A petition for review of the decisions was filed by the District of Columbia on July 26, 1962. (J.A. 73).

## STATUTES INVOLVED

The District of Columbia Income and Franchise Tax Act of 1947, as amended, 61 Stat. 331, ch. 258, provides in Sections 4 (1) and 4 (m) of Title I (Sec. 47-1551c. D. C. Code, 1961) and Sections 1 and 2 of Title III (Sec. 47-1557a. D. C. Code, 1961) as follows:

### TITLE I

* * *

"Sec. 4. General Definitions.—For the purposes of this article and wherever appearing herein, unless otherwise required by the context—

* * *

"(l) The words 'capital assets' mean any property, whether real or personal, tangible or intangible, held by the taxpayer for more than two years (whether or not connected with his trade or business), but do not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the end of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

"(m) The word 'dividend' means any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits, or surplus (other than paid-in surplus), whenever earned by the corporation and whether made in cash or any other property (other than stock of the same class in the corporation if the recipient of such stock dividend has neither received nor exercised an option to receive such dividend in cash or in property other than stock instead of stock) and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation: Provided, however, That in the case of any dividend which is distributed other than in cash or stock in the class in the corporation and not exempted from tax under this article, the basis of tax to the recipient thereof shall be the market value of such property at the time of such distribution: And provided, however, That the word 'dividend' shall not include any dividend paid by a mutual life insurance company to its shareholders."

## TITLE III

"Sec. 1. Net income.—For the purposes of this article and wherever appearing herein, unless otherwise required by the context, the words 'net income' mean the gross income of a taxpayer less the deductions allowed by this article.

"Sec. 2. Gross Income and Exclusions Therefrom—(a) The words 'gross income' include gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, including salaries, wages, and compensation paid by the

United States to its officers and employees to the extent the same is not exempt under this article, or income derived from any trade or business or sales or dealings in property, whether real or personal, other than capital assets as defined in this article, growing out of the ownership, or sale of, or interest in, such property; also from rent, royalties, interest, dividends, securities, or transactions of any trade or business carried on for gain or profit, or gains or profits, and income derived from any source whatever.

"(b) The words 'gross income' shall not include the following:

"(1) Proceeds of Life-Insurance Policies. — The proceeds of life-insurance policies paid by reason of the death of the insured, whether in a single sum or otherwise (but if such amounts are held by the insurer under an agreement to pay interest thereon, the interest payments shall be included in gross income).

"(2) Annuities, and So Forth. — (A) Amounts received (other than amounts paid by reason of the death of the insured and interest payments on such amounts and other than amounts received as annuities) under a life-insurance or endowment contract, but if such amounts (when added to amounts received before the taxable year under such contract) exceed the aggregate premiums or consideration paid (whether or not paid during the taxable year), then the excess shall be included in gross income. Amounts received as an annuity under an annuity or endowment contract shall be included in gross income; except that there shall be excluded from gross income the excess of the amount received in the taxable year over an amount equal to 3 per centum of the aggregate premiums or consideration paid for such annuity (whether or not paid during such year), until the aggregate amount excluded from gross income under this title in respect to such annuity equals the aggregate premiums or consideration paid for such annuity. In the case of a transfer for a valuable consideration, by assignment or otherwise, of a life-insurance, endowment, or annuity contract, or any interest therein, only the actual value of such consideration and the amount of the premiums and other sums subsequently paid by the

transferee shall be exempt from taxation under subsection (1) or this subsection. This subsection and subsection 2 (b) (1) of this title shall not apply with respect to so much of a payment under a life-insurance, endowment, or annuity contract, or any interest therein, as, under section 3 (a) (10) of this title, is includible in the gross income of the recipient.

"(B) Employees' Annuities. —If an annuity contract is purchased by an employer for an employee under a plan with respect to which the employer's contribution is deductible under subsection 3(a) (11) of this title, the employee shall include in his income the amounts received under such contract for the year received except that if the employee paid any of the consideration for the annuity, the annuity shall be included in his income as provided in subsection 2 (b) (2) (A) of this title, the consideration for such annuity being considered the amount contributed by the employee. In all other cases, if the employee's rights under the contract are non-forfeitable except for failure to pay future premiums, the amount contributed by the employer for such annuity contract on and after such rights become nonforfeitable shall be included in the income of the employee in the year in which the amount is contributed, which amount together with any amounts contributed by the employee shall constitute the consideration paid for the annuity contract in determining the amount of the annuity required to be included in the income of the employee under subsection 2 (b) (2) (A) of this title.

"(3) Gifts, Bequests, and Devises. — The value of property acquired by gift, devise, or inheritance (but the income from such property shall be included in gross income).

"(4) Tax-Free Interest. — Interest upon (a) the obligations of a State, Territory of the United States, or any political subdivision thereof, or the District of Columbia; and (b) obligations of the United States, its agencies, or instrumentalities.

"(5) Compensation for Injuries or Sickness. —Amounts received, through accident or health insurance or under workmen's compensation or employer's liability acts, or by way of damages for personal injuries, whether by suit or agreement.

"(6) In the Case of Ministers. —The rental value of a dwelling house and appurtenances thereof furnished to a minister of the gospel as part of his compensation.

"(7) Income Exempt Under Treaty. —Income of any kind to the extent required by any treaty obligation of the United States.

"(8) Income of Foreign Governments.

"(9) Payments Made Under Laws Relating to Veterans. —Payments of benefits made to or on account of a beneficiary under any of the laws relating to veterans.

"(10) Income From Unincorporated Business. —In any case of any person entitled to a share in the net income of any unincorporated business subject to tax under the provisions of title VIII of this article, an amount equal to the proportionate share of such person in such part of such net income as is in excess of the exemption provided in section 4 of said title VIII: Provided, however, That such part so excluded from the gross income of such person shall be reported by and taxed against the unincorporated business under the provisions of title VIII of this article.

"(11) Capital Gains. —Gains from the sale or exchange of any capital asset as defined in this article.

"(12) Personal Services. —If at least 80 per centum of the total compensation for personal services covering a period of thirty-six calendar months or more (from the beginning to the completion of such services) is received or accrued in one taxable year by an individual or a partnership, the tax attributable to any part thereof which is included in the gross income of any individual shall not be greater than the aggregate of the taxes attributable to such part had it been included in the gross income of such

individual ratably over that part of the period which precedes the date of such receipt or accrual.

"(13) Income derived from the sale of tangible personal property to the United States by corporations and unincorporated businesses having their principal places of business located outside the District, which property is delivered from places outside the District for use outside the District: Provided, however, That the taxpayer shall furnish to the Assessor a statement in writing of the amount of gross sales so made and, if required by the Assessor, a list of the names of the agencies of the United States through which such property was sold.

"(14) Dues and initiation fees in the case of any club organized and operated exclusively for pleasure and recreation, no part of the net earnings of which inures to the benefit of any private individual or shareholder. As used in this subsection, the word 'dues' means only sums paid or incurred by members on a monthly, quarterly, annual, or other periodic basis for the privilege of being members of such club and any pro rata assessment made against the members as such; the word 'dues' does not include any sums paid or incurred by members or their guests for food, beverages, or other tangible personal property purchased or for the use of the club's social, athletic, sporting, and other facilities; and the term 'initiation fees' includes any payment, contribution, or loan, required as a condition precedent to membership, whether or not any such payment, contribution, or loan is evidenced by a certificate of interest or indebtedness.

"(c) Adjusted Gross Income.—The words 'adjusted gross income' as used in this article mean gross income less deductions allowed under section 3 (a) of this title: Provided, however, That such deductions were directly incurred in carrying on a trade or business: And provided further, That in determining adjusted gross income, no deductions shall be allowed for charitable contributions, alimony payments, medical and dental expenses, an optional standard deduction, losses of property not connected with trade or business, or for an allowance for salaries or compensation for personal services of the person or persons liable for the tax."

## STATEMENT OF POINTS

1. The District of Columbia Tax Court erred in concluding that individual income taxes assessed against respondents by petitioner for the calendar years 1959 and in Docket Numbers 1762 and 1763 for the calendar year 1960, were, in the amounts set forth in decisions of that Court, erroneously paid by and collected from respondents, and that respondents are entitled to refund thereof with interest.

2. The District of Columbia Tax Court erred in concluding that respondents' gross income for District of Columbia income tax purposes did not include the entire distributions made to them from the corporations involved during each of the calendar years in question.

## SUMMARY OF ARGUMENT

Respondents, as stockholders in corporations engaged in the ownership and operation of real property, received certain distributions from these corporations during the taxable years in question, which distributions the Tax Court held were made from so-called "depreciation reserves" and, as such, were not includible in the gross income of respondents under the gross income provision of the District of Columbia Income and Franchise Tax Act of 1947, as amended.

The Tax Court held that the only taxable distributions received by stockholders of the corporations involved were those which qualified as a "dividend" as defined in the Act. However, the statutory gross income provision provides that gross income shall include, inter alia, "dividends" "* * * and income derived from any source whatever." No provision, moreover, is made by the Act for excluding from gross income distributions out of so-called "depreciation reserves."

The Supreme Court has considered gross income provisions in Federal statutes similar to that in the District's statute, and has stated on many occasions that the various gross income provisions should be given a liberal construction in recognition of the intention of Congress to tax all gains except those specifically exempted.

Although the Income and Franchsie Tax Act does not impose a tax upon stockholders receiving merely a return of their original capital

investment in the corporation, it does subject to tax distributions which the court below characterized in these cases as being distributions out of "depreciation reserves."

To the extent that they eliminated from District tax distributions to petitioners out of "depreciation reserves," the decisions of the Tax Court ought to be reversed.

## ARGUMENT

In its opinion, the District of Columbia Tax Court held that distributions made to stockholders of the Berkshire and Queenstown corporations out of so-called "depreciation reserves" are not subject to District income taxes since they constituted a return of capital to the stockholders.

The District of Columbia contends that all distributions made by the Berkshire and Queenstown corporations during the years in question are subject in full to District income taxes under the provisions of Section 2 of Title III of the District of Columbia Income and Franchise Tax Act of 1947, as amended (Section 47-1557a, D. C. Code, 1961), which provides:

> "Sec. 2. Gross Income and Exclusions Therefrom.—
> (a) The words 'gross income' include gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, including salaries, wages, and compensation paid by the United States to its officers and employees to the extent the same is not exempt under this article, or income derived from any trade or business or sales or dealings in property, whether real or personal, other than capital assets as defined in this article, growing out of the ownership, or sale of, or interest in, such

> property; also from rent, royalties, interest, dividends, securities, or transactions of any trade or business carried on for gain or profit, or gains or profits, and income derived from any source whatever." (Emphasis Supplied.)

Subsection (b) of Section 2 of Title III of the Act sets forth the exclusions from gross income. No provision is made to exclude distributions such as those in dispute, even though such distributions could be said to be out of "depreciation reserves," as the Tax Court held in these cases.

Section 2 of Title III of the Act clearly provides that gross income includes gains and profits and also specifies that gross income shall include "* * * income derived from any source whatever." It is obvious that Congress included this provision in the District's Income and Franchise Tax Act to effect taxation of all distributions made to stockholders of a corporation whether in the form of a "dividend," as defined elsewhere in the District Act, or from any other source whatever other than a return of the capital investment of the stockholder in the corporation.

The Tax Court erroneously stated:

> "The sole question presented in these cases is whether the entire amount of money distributed by the four corporations to the petitioners were taxable dividends under Section 4(m) of Title I of the District of Columbia Income and Franchise Tax Act of 1947 (Section 47-1551c, (m), D. C. Code, 1961 Edition), * * *" (J. A. 31).

Both at the hearing of these cases and in its brief filed in the Tax Court, the District of Columbia urged that whether or not distributions from "depreciation reserves" can be considered "dividends" under the definition in the Act,

they were nevertheless taxable under the gross income provision, cited above. The Tax Court, as noted above, ignored this provision and confined its opinion to the consideration of whether or not these distributions qualified as "dividends" under the District Act.

Section 2 of Title III of the Act is similar to Section 22(a) of the Internal Revenue Code of 1939 which was considered by the Supreme Court of the United States in Commissioner of Internal Revenue v. Glenshaw Glass Company, 348 U.S. 426, 99 L.ed. 483, 75 S.Ct. 473. The Supreme Court said at page 5 of its opinion:

> " This Court has frequently stated that this language was used by Congress to exert in this field 'the full measure of its taxing power.' (authorities cited) * * *. Respondents contend that punitive damages, characterized as 'windfalls' flowing from the culpable conduct of third parties, are not within the scope of the section. But Congress applied no limitations as to the source of taxable receipts, nor restrictive labels as to their nature. And the Court has given a liberal construction to this broad phraseology in recognition of the intention of Congress to tax all gains except those specifically exempted. * * * Such decisions demonstrate that we cannot but ascribe content to the catch-all provision of § 22(a), ' gains or profits and income derived from any source whatever.' The importance of that phrase has been too frequently recognized since its first appearance in the Revenue Act of 1913 to say now that it adds nothing to the meaning of 'gross income.' " (Emphasis Supplied.)

In Douglas v. Willcuts, 296 U.S. 1, 80 L.ed. 3, 56 S.Ct. 59, the Court considered the gross income provision as it appeared in the 1926 Revenue Act, saying:

"No question is raised as to the constitutional power of the Congress to attribute to petitioner the income thus segregated and paid in discharge of his obligation, and that authority could not be challenged successfully. Burnet v. Wells, 289 U.S. 670, 677, 682, 684. The question is one of statutory construction. We think that the definitions of gross income (Revenue Acts, 1926, § 213; 1928, § 22) are broad enough to cover income of that description. They are to be considered in the light of the evident intent of the Congress 'to use its power to the full extent.' * * *"

In Helvering v. Clifford, 309 U.S. 331, 84 L.ed. 788, 60 S.Ct. 554, the Court considered the gross income provision in the Revenue Act of 1934:

"Sec. 22(a) of the Revenue Act of 1934 , 48 Stat. 680, includes among 'gross income' all 'gains, profits, and income derived . . . from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.' The broad sweep of this language indicates the purpose of Congress to use the full measure of its taxing power within those definable categories. Cf. Helvering v. Midland Mut. L. Ins. Co., 300 U.S. 216. Hence our construction of the statute should be consonant with that purpose. Technical considerations, niceties of the law of trusts or conveyances, or the legal paraphernalia which inventive genius may construct as a refuge from surtaxes should not obscure the basic issue. * * *"

See also Irving v. Gavit, 268 U.S. 161, 69 L.Ed. 897, 45 S.Ct. 475; Helvering v. Midland Mut. L. Ins. Co., 300 U.S. 216, 81 L.ed. 612, 57 S.Ct. 423, 108 ALR 436.

There is no indication that Congress, in including a gross income provision in the District Income and Franchise Tax Act similar to that which

has appeared in the various federal revenue acts since 1913, has intended gross income for District tax purposes to be any more limited than under the Federal acts, aside from specific provisions of law restricting the meaning of gross income. As the Supreme Court said in Glenshaw Glass Company, supra, the Court has construed the phraseology of this provision broadly in recognition of the intent of Congress to tax all gains except those specifically exempted.

Considering the history of this provision and its interpretation by the Courts, there is no basis for the limited, narrow construction placed upon the provision by the Tax Court.

The Tax Court characterizes the distribution from the "depreciation reserves" as a return of capital and concludes, as a consequence, that such distributions are not includible in gross income. Capital has been defined on numerous occasions by the United States Supreme Court and the various Federal and state courts and nothing set forth in the authorities requires a different treatment of the term under the District's taxing statute.

In Bailey v. Clark, 88 U.S. (21 Wall) 284, 22 L.Ed. 651, the Supreme Court said:

> "* * * the only question for determination relates to the meaning to be given to the term capital in the one hundred and tenth section of the Revenue Act. The term is not there used in any technical sense, but in its natural and ordinary signification. * * * When used with respect to the property of a corporation or association the term has a settled meaning; it applies only to the property or means contributed by the stockholders as the fund or basis for the business or enterprise for which the corporation or association was formed. * * *" (Emphasis Supplied.)

This definition has been followed by various federal and state courts. In Malley v. Old Colony Trust Company, 299 F. 523, the Court said at page 528:

> "* * * Capital has a settled meaning when used with respect to the property of a corporation, and applies only to the property or amounts contributed by the stockholders as the fund or basis of the enterprise for which the corporation was formed. * * *"

See also People ex rel. Union Ferry Company of New York & Brock v. Roberts, 66 App. Div. 157, 72 N.Y.S. 950.

In Allied Chemical & Dye Corp. v. McMahon, 156 F. Supp. 275, affirmed 253 F. 2d 663, cert. denied 358 U.S. 829, the United States District Court for the Southern District of New York in 1957 interpreted "capital" as used in a Federal Internal Revenue statute:

> "'Capital', in the sense of the original investment by the owners of a corporation, is usually shown in the capital stock account. According to the type of stock, this is the aggregate of the par value or the stated value or the actual value of the shares issued. This account remains unchanged except insofar as the stockholders contribute additional funds to the corporation or withdraw their original investment from it. The fluctuation in the value of the business is not shown by a change in this account but rather by the fluctuation of the surplus account.
>
> "'Capital' in a less precise sense is also used to describe the proprietorship interest of the owners of the corporation at any given time. In this sense it is shown by the total of the capital stock and the surplus accounts. The surplus account may be derived from earnings or from amounts paid into the corporation from various sources, including contributions or payments by stockholders in excess of the amounts shown in the capital stock account. Capital in this sense, however, is not spoken of as 'dedicated.' Capital in this sense is simply the excess of assets over liabilities at the time in question.

> "It is my belief that the statute uses 'capital' in the former sense, meaning the contributions of the stockholders to the corporation. In such a sense it is shown by the capital stock account."

See also Crocker v. Waltham Watch Company, 315 Mass. 397, 53 N.E. 2d 230.

In Berliner v. District of Columbia, 103 U.S.App.D.C. 351, 258 F.2d 651, cert. denied 357 U.S. 937, the Court noted and the opinion indicates approved, a stipulation of the parties in that case that a return of "capital" is not, of course, a taxable distribution. "Capital", in this context, as the Court stated in footnote 2 of its opinion, means:

> "(2) I.e. an amount equal to the original capital paid in (the par value of their common stock) by the stockholders."

Later in its opinion, in rejecting petitioners' arguments that the Fifth Amendment prohibits taxation as dividends of amounts distributed in liquidation to the extent that they represent corporate earnings, the Court said:

> "In respect of the taxpayers here, the argument overlooks the fact that the distributions not only returned to them their capital investments in full, but also a substantial additional amount as a gain or profit."

Respondents, once their "capital" investment has been returned to them in full are receiving, so far as they are concerned, income. It is not the distributing corporations which are being taxed in this case; it is the recipients of the corporate distributions.

In substance, there is no real distinction between the distributions to the stockholders in Berliner and the distributions to respondents here.

When respondents have received back from the distributing corporations their "capital" investment, represented by the par value of their stock, any additional distribution is, as to them, income.

The evidence adduced at the hearing of the cases in the Tax Court clearly indicates that respondents recovered back their capital investment long before the distributions from the "depreciation reserves" of these corporations now in controversy were made (J.A. II). The original capital investment of the stockholders is the only return of capital not subject to District income tax.

## CONCLUSION

The gross income provision contained in Section 2 of Title III of the District of Columbia Income & Franchise Tax Act, as amended, supra, provides for a tax on income derived from any source whatever. Virtually identical language in the Federal taxing statutes has been construed by the Supreme Court as including all income not specifically exempted by the statute. The distributions made to the stockholders of the corporations in question out of "depreciation reserves" clearly must be included as taxable income under the District statute.

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HENRY E. WIXON
Assistant Corporation Counsel, D. C.
HARRISON S. HOWES
Assistant Corporation Counsel, D. C.
Attorneys for Petitioner, District Building,
Washington 4, D. C.

# JOINT APPENDIX

INDEX

Subject Index

DISTRICT OF COLUMBIA TAX COURT

FILED
Nov. 15, 1961

HYMAN GOLDMAN and
YETTA D. GOLDMAN,

Petitioners,

vs.

DISTRICT OF COLUMBIA,

Respondent.

Docket No. 1761

## PETITION

The above-named petitioners appeal from an assessment of taxes against them, and aver as follows:

1. The petitioners are husband and wife with residence at 4000 Massachusetts Avenue, N.W., Washington, D. C.

2. The tax in controversy is a deficiency in income tax for the taxable period ended December 31, 1958, in the amount of $191.12 and a deficiency for the taxable period ended December 31, 1959, in the amount of $125.01 and such taxes were paid on or about September 15, 1961.

3. The notice of deficiency and statement of taxes due was dated August 18, 1961, as will appear from the copy thereof hereto attached as Exhibit 'A'. A copy of the statement accompanying the original report of examination is attached as Exhibit 'B' hereto.

4. The assessment of taxes is based upon the following errors:

(a) That distributions received by the taxpayers as stockholders of two corporations, known as The Berkshire, Inc. and Queenstown Apartments (various sections), are taxable as gross income within the meaning of Title III, Section 2(a) of the D. C. Income and Franchise Tax Act of 1947, as amended (Sect. 47-1557a(a), D. C. Code, 1951 Ed.).

5. The facts upon which the petitioners rely as the basis of this case are as follows:

(a) During the years in question petitioners were stockholders of the various corporations referred to in paragraph 4. As such stockholders, they received certain distributions from said corporations which were made from funds available from accumulated depreciation and were not the result of earnings either during the year of distribution, or prior thereto.

(b) Petitioners contended before the Finance Officer, and contend now before this Court, that the said distributions represent payments of capital with respect to the ownership of property, defined under District law as a capital asset and, therefore, are not taxable as alleged by the respondent.

WHEREFORE, the petitioners pray that this Court may hear the case and

1. Enter its finding and decision that the deficiencies determined by the respondent are in error and contrary to law.

2. Order the respondent to refund the deficiency collected in the total amount of $316.13, plus interest, as provided by law, including the interest collected as part of deficiency.

* * *

EXHIBIT A

GOVERNMENT OF THE DISTRICT OF COLUMBIA
FINANCE OFFICE • Revenue Division

INCOME AND FRANCHISE TAX

EXHIBIT A

| TYPE TAX | ACCOUNT NUMBER | REF. | TYPE TAX | TAX YEAR | DATE | |
|---|---|---|---|---|---|---|
| I - Individual Income; D - Declaration Payment; H - Corporation; J - Unincorporated Business; F - Fiduciary; E - Employer Withholding | 1989930 | | I | 1958 | 8/18/61 | |

| NAME AND ADDRESS | TOTAL TAX DOLLARS | TOTAL TAX CTS. | CREDIT DOLLARS | CREDIT CTS. | INTEREST TO | PAYMENT DUE DOLLARS | PAYMENT DUE CTS. |
|---|---|---|---|---|---|---|---|
| Goldman, H. & Y. D.<br>4000 Reds. Ave. N.<br>Washington, D. C.<br>20,118.13 | 191.42+<br>27.71+ | | | | SEP 15'61 | 218.53* | |

Interest on payment due at the rate of ½ of 1% per month or portion thereof must be added if not paid on or before the interest date shown on this bill. Late filing penalty is computed at 5% per month or portion thereof (maximum 25%), except type tax E which is a flat 25%.

Make check payable to D. C. TREASURER. Send check or money order to FINANCE OFFICE, REVENUE DIVISION, Municipal Center, Washington 1, D. C.

Your cancelled check is your receipt.

| | | |
|---|---|---|
| Interest at rate of ½ of 1% per month or portion thereof from to | | |
| TOTAL PAYMENT DUE → | | |

KEEP THIS COPY

COPY (A-TAXPAYER'S COPY

EXHIBIT "B"

Hymen and Yetta D. Goldman
4000 Massachusetts Ave. N.W.
Washington D.C.

| | | | | | |
|---|---|---|---|---|---|
| Calendar Year | | | | 1958 | |
| Taxable Income per form D-40 | | | | | 1836207 |
| Add: (1) Capital Distribution (a) Berkshire, Inc. | | | | | 500046 |
| Total | | | | | 2336253 |
| Less: (2) Additional Contributions | | | | | 57139 |
| Taxable Income as revised | | | | | 2279114 |
| Tax | | | | | 775.60 |
| Less: Tax reported | | | | | 584.48 |
| Deficiency | | | | | 191.12 |

(1) (a) The distribution received from the Berkshire Inc. which was considered to be nontaxable as gross income as defined in Title III Sec 2 (a) of the act and so therefore taxable

(2) Additional Contributions are allowed because of the increased Adjusted Gross Income which increases the maximum Contributions allowable.

DISTRICT OF COLUMBIA TAX COURT

FILED
Nov. 29, 1961

* * *

## AMENDED PETITION

Pursuant to Rule 11(b)(1) of this Court, the above-named petitioners amend their petition, filed herein November 15, 1961, as follows:

1. So much of paragraph 2 of the petition is deleted as relates to the deficiency for the taxable year ended December 31, 1959 and in lieu thereof, there is substituted after "the amount of $191.12":

and a deficiency of $274.58 for the taxable period ended December 31, 1959, and such taxes in the amount of $191.12 were paid on or about September 15, 1961, and taxes in the amount of $274.58 were paid on November 17, 1961.

2. The first clause of paragraph 3 of the petition is deleted and in lieu thereof there is substituted:

The notice of deficiency and statement of taxes due for the year 1958 was dated August 18, 1961 and the notice of deficiency and statement of taxes due for the year 1959 was dated November 13, 1961.

3. The second prayer for relief on page 2 of the petition is deleted and in lieu thereof is substituted:

Order the respondent to refund the deficiency collected in the total amount of $465.70, plus interest as provided by law, including the interest collected as part of the deficiency.

* * *

COPY 1A – TAXPAYER'S COPY

# GOVERNMENT OF THE DISTRICT OF COLUMBIA
FINANCE OFFICE • Revenue Division

# INCOME AND FRANCHISE TAX

TYPE TAX: I - Individual Income; D - Declaration Payment; N - Corporation; U - Unincorporated Business; F - Fiduciary; E - Employer Withholding

| ACCOUNT NUMBER | REF. | TYPE TAX | TAX YEAR | DATE |
|---|---|---|---|---|
| 2:061-03 | | | 1959 | 11/13/61 |

| NAME AND ADDRESS | TOTAL TAX DOLLARS | TOTAL TAX CTS. | CREDIT DOLLARS | CREDIT CTS. | INTEREST TO | PAYMENT DUE DOLLARS | PAYMENT DUE CTS. |
|---|---|---|---|---|---|---|---|
| Goldman, Hymen & Yetta<br>4000 Mass. Ave., N. W.<br>Washington, D. C.<br>25 216.57 | 27A08+<br>27.46+ | | 3 | | DEC 1961 | 302.04* | |

Interest on payment due at the rate of ½ of 1% per month or portion thereof must be added if not paid on or before the interest date shown on this bill. Late filing penalty is computed at 5% per month or portion thereof (maximum 25%), except type tax E which is a flat 25%.

Make check payable to D. C. TREASURER. Send check or money order to FINANCE OFFICE, REVENUE DIVISION, Municipal Center, Washington 1, D. C.

Your cancelled check is your receipt.

Interest at rate of ½ of 1% per month or portion thereof
from to

TOTAL PAYMENT DUE →

KEEP THIS COPY

By order dated January 22, 1963, this Court granted a joint motion of the parties for leave to file a single representative pleading in this Joint Appendix. This pleading appears above. The following schedule sets forth the pertinent information contained in the petitions in the other cases filed in the District of Columbia Tax Court from which appeals are being taken to this Court. Petitions 1762 through 1770 were filed November 15, 1961. Petitions 1771 through 1780 were filed November 16, 1961.

| Docket No. | Petitioners | Tax Year | Amount of Tax | Date of Assessment | Date of Payment |
|---|---|---|---|---|---|
| 1762 | David L. Blanken | 1959 | $ 54.15 | 8-18-61 | 9-7-61 |
| | | 1960 | 110.51 | 10-30-61 | 11-9-61 |
| 1763 | Edna R. Blanken | 1959 | 40.61 | 8-18-61 | 9-7-61 |
| | | 1960 | 106.45 | 10-30-61 | 11-9-61 |
| 1764 | Leo Schlossberg Goldyne Schlossberg | 1959 | 214.58 | 8-18-61 | 10-4-61 |
| 1765 | Irene Schlosberg | 1959 | 220.92 | 8-18-61 | 10-9-61 |
| 1766 | Benjamin Blanken | 1959 | 59.42 | 8-18-61 | 9-15-61 |
| 1767 | Faye B. Blanken | 1959 | 35.74 | 8-18-61 | 9-15-61 |
| 1769 | Ida Magazine | 1959 | 49.32 | 8-18-61 | 9-11-61 |
| 1770 | Anne Gelfand | 1959 | 22.50 | 8-18-61 | 9-15-61 |
| 1771 | Herbert M. Gelfand | 1959 | 24.17 | 8-18-61 | 9-20-61 |
| 1772 | Meyer Gelfand and Herbert Gelfand, Executors of the Estate of Harry Gelfand and Sarah Gelfand | 1959 | 238.80 | 8-18-61 | 9-26-61 |
| 1773 | Meyer Gelfand | 1959 | 290.12 | 8-18-61 | 9-26-61 |
| 1775 | Cecile S. Goldman | 1959 | 225.85 | 8-18-61 | 9-15-61 |
| 1776 | Esther M. Handleman | 1959 | 24.18 | 8-18-61 | 9-14-61 |
| 1778 | Edward Zupnik | 1959 | 128.37 | 9-8-61 | 9-15-61 |
| 1779 | Fannie Zupnik | 1959 | 150.85 | 8-18-61 | 9-15-61 |
| 1780 | Joseph J. Zupnik | 1959 | 176.51 | 8-18-61 | 9-15-61 |

EXCERPTS FROM TRANSCRIPT OF PROCEEDINGS

Washington, D. C.

Thursday, February 1, 1962

The above-entitled matter came on for hearing, pursuant to notice, at 10:00 o'clock a.m.

BEFORE:

THE HONORABLE JO V. MORGAN

* * *

THE COURT: Mr. Howes, are you going to try this case?

MR. HOWES: Yes, your Honor.

THE COURT: You made a statement as to what your position was?

MR. HOWES: I don't know that is our position, your Honor. We do claim that under Title 3, Section 2 of the Act, that these distributions come under gross income.

THE COURT: Suppose you read what it does say and refresh my recollection.

MR. HOWES: Section 2, Gross Income, Exclusion Therefrom: The words "gross income" include gains, profits, and income derived from salaries, wages, or compensations for personal services or whatever kind and in whatever form paid including salaries, wages, and compensation paid by the United States to its officers and employees, to the extent the same is not exempt under this article or income derived from

any trade or business or sales or dealings in property whether real or personal other than capital assets as defined in this article growing out of the ownership or sale of or interest of such property; also from rent, royalties, interest, dividends, securities or transactions of any trade or business carried on for gain or profit or gains or profits and income derived from any sources whatever.

Now, your Honor, that is just about as broad as it seems to me you can get, and I think we will have to narrow it down somewhat, but I would like to read also the definition in the act of dividends and I think that will probably narrow this down to some extent.

The definition of "dividend" is in Title 1, Section 4. The word "dividend" means any distribution made by a corporation, domestic or foreign, to its stockholders or members out of its earnings, profits or surplus other than paid in surplus whenever earned by the corporation and whether made in cash or any other property other than stock of the same class in the corporation if the recipient of such stock dividend has neither received nor exercised an option to receive such dividend in cash or in property other than stock instead of stock and whether distributed prior to, during, upon or after liquidation or dissolution of the corporation.

I don't think the rest is pertinent, your Honor.

THE COURT: Do you think this is a dividend?

* * *

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I don't think the rest is pertinent, your Honor.

THE COURT: Do you think this is a dividend?

* * *

MR. HOWES: I don't contend it is a dividend as such because they have not characterized it as such but I think it is included in the gross income and reading Section --

THE COURT: What exact language in this very broad statement would cover this? You must have something in mind that would match it.

MR. HOWES: To be very frank with you, I am not entirely familiar with the distribution as it has been made from the Corporation. One of the reasons we are here this morning is for me to find out.

THE COURT: You shoot them with a shotgun instead of a rifle?

MR. HOWES: No, but we know it is not a distribution from capital from our knowledge of the corporations. We know it is made out of the earnings of the corporation, and I think under that definition comes under gross income and probably is a dividend.

* * *

OLIVER W. HIGGS

was called as a witness, duly sworn and testified as follows:

* * *

DIRECT EXAMINATION

BY MR. STRUPP:

Q Would you state your full name Mr. Higgs, please?

A Oliver W. Higgs.

Q And your address?

A Office address is 1735 DeSales Street, Northwest, Washington, D. C.

Q And your occupation?

11 A I am a certified public accountant.

* * *

78 RECROSS EXAMINATION

BY MR. HOWES:

Q Mr. Higgs, does the book reflect whether the people have recovered their initial capital investment, or not?

A No, sir...the book would not reflect that.

THE COURT: You know they did, at $500.00.

Q I want to know if it's in the book, your Honor.

A No, sir, it would not reflect that.

Good accounting principles would not permit so.

The stock hasn't been retired. This would be the only way you would be able to wipe it off the book.

* * *

* * *

83 Washington, D. C.

Friday, February 9, 1962

The above-entitled matter came on for hearing, pursuant to adjournment, at 10:00 o'clock, a. m.

BEFORE:

THE HONORABLE JO V. MORGAN

* * *

PROCEEDINGS

* * *

85 OLIVER W. HIGGS

was recalled as a witness and was further examined and testified as follows:

* * *

103 THE COURT: * * * We know that they had a reserve for depreciation. We know it was not funded except to a very small degree. We know they earned - - they had property. They made a distribution of cash, and I would like to know from accounting, which is a science, as you well know, what is it. What do you represent. Did it represent, as they say, a part of capital or was it all from surplus and could not be designated capital?

MR. WIXON: I would think, your Honor, that any statements by this witness on this subject - -

THE COURT: He is a Certified Public Accountant.

MR. WIXON: Would be self serving, sir.

THE COURT: He is employed by them as a C. P. A. He can testify as an expert. It may be clothed with a little bit of prejudice but you can argue that; but I will take that into consideration. He is employed by these people all the time; but that doesn't mean it is not proper testimony

* * *

* * *

104 MR. STRUPP: I think as nearly as I can recall, what I said was - -
105
I asked you, do you know from, or can you state from your familiarity with these books and records as well as from the records of other companies that you may be familiar with, in what manner distributions have become available; the source of distribution has become available in situations such as we have before us at the present time?

MR. WIXON: Your Honor, you understand I have an objection to the question now posed?

THE COURT: Yes. I overruled the objection.

* * *

106 THE WITNESS: Your general statement would be this, sir. You have a write-off for depreciation. This write-off is based upon an estimated economic useful life. This of course, is applicable to the cost of the asset, in this case the building. This is the thing that is being depreciated and

the mechanics are that you would have a charge against earnings for the amount of the annual depreciation; a credit into the reserve for the depreciation against this particular building; the earnings statement for the year shows a net profit. In a rental situation, substantially all of your income is in cash. So when you have a net profit situation you have net cash. This is a net profit after the book entry deduction for depreciation.

Now, you also have against that building a mortgage. The mortgagee wants periodic payments against it. To the extent that the charge per annum for depreciation may exceed the requirements of principle amortization on that mortgage and your profit and loss statement ends with a net profit figure, you have generated cash to the difference between your depreciation charge for that year and the required amortization for that year.

Have I made myself clear?

THE COURT: Yes.

* * *

108 THE COURT: Suppose you did not have to pay $50,000 on the mortgage and you have $150,000 in the till. There is no reason why they could not distribute - - and many corporations do. They distribute the whole $150,000. What I am interested in, from a purely accounting viewpoint, is what is represented by the $50,000 that would have been paid on the mortgage if the mortgage were in existence. That is, the $50,000 or at least, the amount of $50,000 that cannot be the same thing. You have nothing really

physically taken out and put in a fund that you set off for depreciation. That is what I am interested in and I need help. I don't say it is earnings. I don't say it is capital.

MR. STRUPP: Can you explain that further, Mr. Higgs?

THE WITNESS: If I understand your question, sir, it comes back to what is the source of this fund. You are right. I probably did not go far enough in my explanation. As I previously stated, where the charge against operations is in excess of the requirements of amortization, this
109 will produce cash. Now, you have the cash available for distribution. You distribute it. The amount that exceeds the current year's earnings, assuming a zero surplus at the beginning of the year, can only come from one source. It can come from the wasting of the corporation's capital asset - - the building, in this example - - through this charge.

* * *

OPINION NO. 996

* * *

FILED

MAY 8 1962

District of Columbia
Tax Court

* * *

6 **FINDINGS OF FACT AND OPINION**

The petitioners are here protesting the assessments of income taxes for the years 1958, 1959 and 1960, on amounts distributed to them by corporations owning and operating apartment houses. They contend that the amounts distributed were capital assets and not taxable by the District of Columbia. The respondent claims that the amounts were dividends within the meaning of the District of Columbia Income and Franchise Tax Act of 1947 (Chapter 15, Title 47, D. C. Code, 1961 Ed.).

Findings of Fact

1. The petitioners are individuals residing in the District of Columbia. They are common stockholders of the corporations following: The Berkshire, Inc., Queenstown Apartments, Section A, Inc., Queenstown Apartments, Section B, Inc. and Queenstown Apartments, Section E, Inc. which are owners and operators of large apartment buildings.

I

The Berkshire, Inc.

2. (a) The Berkshire, Inc. is a corporation. It is the owner of a large apartment building, in two sections, located in Washington, D. C., known as "The Berkshire" and hereinafter so called.

(b) The Berkshire was completed in 1951. Its operation has been highly successful. At a date some time prior to the taxable years involved The Berkshire, Inc. had redeemed preferred stock of approximately $243,500, and paid off ordinary loans of approximately $250,000. In addition, by the end of 1960 it had reduced the mortgage
7 indebtedness on the building by $1,224,643.04. The record does not disclose the amount of dividends paid or distributions made to its stockholders during the years prior to 1958, but the dividends paid or distributions made during the taxable years involved (1958, 1959 and 1960) exceed $500,000.

(c) During the taxable years involved the entire capitalization of The Berkshire, Inc. was 100 shares of preferred stock of the par value of $1.00 each, or a total par value of $100.00, held by the United States for protective or control purposes under an agreement; and 500 shares of common stock of the par value of $1.00 each, or a total of $500.00 for all the common stock.

3. The net earnings from the Berkshire for the years 1954 to 1960, inclusive, were as follows:

| Year | Before U. S. Income Taxes | U. S. Income Tax | Net Earnings |
|---|---|---|---|
| 1954 | $103,573.16 | $48,358.04 | $55,215.12 |
| 1955 | 80,128.99 | 36,167.07 | 43,961.92 |
| 1956 | 80,989.68 | 36,954.98 | 44,034.20 |
| 1957 | 64,691.90 | 28,139.79 | 36,552.11 |
| 1958 | 61,769.95 | 26,179.01 | 35,590.94 |
| 1959 | 83,493.25 | 37,912.36 | 45,580.89 |
| 1960 | 97,004.70 | 44,680.81 | 52,323.89 |

4. (a) The amounts of earnings from the Berkshire for the aforesaid years are computed by deducting from gross operating profit the allowances for depreciation of physical assets following:

| Year | Depreciation Allowance |
|---|---|
| 1954 | $242,593.06 |
| 1955 | 249,307.51 |
| 1956 | 254,917.65 |
| 1957 | 254,502.80 |
| 1958 | 256,921.04 |
| 1959 | 256,244.05 |
| 1960 | 255,164.94 |

8 (b) The depreciation reserves set up in relation to the Berkshire for the aforesaid years were as follows:

| Year | Depreciation Reserves |
|---|---|
| 1954 | $ 987,591.58 |
| 1955 | 1,236,899.09 |
| 1956 | 1,491,816.74 |
| 1957 | 1,746,319.54 |
| 1958 | 2,003,240.58 |
| 1959 | 2,262,180.96 |
| 1960 | 2,517,345.90 |

(c) The "Depreciation Reserve" represented or was intended to represent the accumulation over the years of the amounts of "depreciation" deduction or allowance, and were bookkeeping entries.

(d) With the exception of a small reserve fund deposited with the mortgagee as a deposit for interest and the like under the terms of the mortgage agreement, no fund was established to provide for depreciation. The amounts shown as representing depreciation were bookkeeping entries.

4. (a) The reconciliation of cash in relation to the operation of the Berkshire for the taxable years involved is as follows:

1958

| Items | Additions | Deductions |
|---|---|---|
| Accounts Receivable | | $ 6,418.12 |
| Prepaid Assets | $ 180.63 | |
| Funded Reserves | 4,787.46 | |
| Depreciable Assets Acquired | | 18,788.67 |
| Write-off of Depreciation (added to the Reserve for Depreciation) | 256,921.04 | |
| Accrued Operating Expenses | 4,352.49 | |
| Accrued Interest | | 460.69 |
| Accrued Taxes | | 2,159.24 |
| Principal Payments on Mortgages Payable | | 138,208.65 |
| Net Profit From Operations (after Income Taxes) | 28,569.77 | |
| TOTALS | $294,811.39 | $166,035.37 |
| Amount to Balance (actual cash throw-off from operations) | $128,776.02 | |
| Cash at the beginning of the year | 116,202.21 | $244,978.23 |
| Less: Distribution paid on 1/2/58 | | 100,005.00 |
| Cash at the close of the year | | $144,973.23 |

9

1959

| Items | Additions | Deductions |
|---|---|---|
| Accounts Receivable | $ 23,821.27 | |
| Prepaid Assets | 2,783.08 | |
| Funded Reserves | | $ 63,552.50 |
| Depreciable Assets Acquired | | 1,777.22 |
| Write-off of Depreciation (added to the Reserve for Depreciation) | 256,244.05 | |
| Accrued Operating Expenses | 1,747.28 | |
| Accrued Interest | | 479.47 |
| Accrued Taxes | 12,920.93 | |
| Principal Payments on Mortgages Payable | | 143,839.46 |
| Net Profit From Operations (after Income Taxes) | 46,774.73 | |
| TOTALS | $344,291.34 | $209,648.65 |
| Amount to Balance (actual cash throw-off from operations) | $134,642.69 | |
| Cash at the beginning of the year | 144,973.23 | $279,615.92 |
| Less: Distribution paid on 1/22/59 | | 120,005.00 |
| Cash at the close of the year | | $159,610.92 |

1960

| Items | Additions | Deductions |
|---|---|---|
| Accounts Receivable | $ 704.08 | |
| Prepaid Assets | 1,307.42 | |
| Funded Reserves | | $ 22,641.43 |
| Depreciable Assets Acquired | | 10,039.97 |
| Write-off of Depreciation (added to the Reserve for Depreciation) | 255,164.94 | |
| Accrued Operating Expenses | | 197.00 |
| Accrued Interest | | 499.00 |
| Accrued Taxes | 7,442.29 | |
| Principal Payments on Mortgages Payable | | 149,699.72 |
| Net Profit From Operations (after Income Taxes) | 51,820.75 | |
| TOTALS | $316,439.48 | $183,077.12 |

| | | |
|---|---|---|
| Amount to Balance (actual cash throw-off from operations) | $133,362.36 | |
| Cash at the beginning of the year | 159,610.92 | $292,973.28 |
| Less: Distribution paid on 1/4/60 | $150,005.00 | |
| Distribution paid on 12/28/60 | 140,000.00 | 290,005.00 |
| Cash at the close of the year | | $ 2,968.28 |

10 (b) The item "Distribution" in the foregoing statements represents distribution made to stockholders, the character of which is the subject of controversy in these cases.

5. The amounts paid in reduction of mortgages on the Berkshire (Sections A and B) are the following:

| Mortgages | Section A | Section B | Total Reduction of Mortgages |
|---|---|---|---|
| Original Amount (2/28/51) | $3,960,000.00 | $2,801,000.00 | |
| Balance at 12/31/51 | 3,918,922.67 | 2,771,945.01 | |
| Amortization | $ 41,077.33 | $ 29,054.99 | $ 70,132.32 |
| " " 1/1/52 | $3,918,922.67 | $2,771,945.01 | |
| " " 12/31/52 | 3,855,219.37 | 2,726,886.13 | |
| Amortization | $ 63,703.30 | $ 45,058.88 | $108,762.18 |
| " " 1/1/53 | $3,855,219.37 | $2,726,886.13 | |
| " " 12/31/53 | 3,788,920.70 | 2,679,991.48 | |
| Amortization | $ 66,298.67 | $ 46,894.65 | $113,193.32 |
| " " 1/1/54 | $3,788,920.70 | $2,679,991.48 | |
| " " 12/31/54 | $3,719,920.95 | 2,631,186.26 | |
| Amortization | $ 68,999.75 | $ 48,805.22 | $117,804.97 |
| " " 1/1/55 | $3,719,920.95 | $2,631,186.26 | |
| " " 12/31/55 | 3,648,110.04 | 2,580,392.64 | |
| Amortization | $ 71,810.91 | $ 50,793.62 | $122,604.53 |

| | | | | |
|---|---|---|---|---|
| Balance at | 1/1/56 | $3,648,110.04 | $2,580,392.64 | |
| " | " 12/31/56 | 3,573,373.43 | 2,527,529.61 | |
| | Amortization | $ 74,736.61 | $ 52,863.03 | $127,599.64 |
| " | " 1/1/57 | $3,573,373.43 | $2,527,529.61 | |
| " | " 12/31/57 | 3,495,591.92 | 2,472,512.87 | |
| | Amortization | $ 77,781.51 | $ 55,016.74 | $132,798.25 |
| " | " 1/1/58 | $3,495,591.92 | $2,472,512.87 | |
| " | " 12/31/58 | 3,414,641.48 | 2,415,254.66 | |
| | Amortization | $ 80,950.44 | $ 57,258.21 | $138,208.65 |
| " | " 1/1/59 | $3,414,641.48 | $2,415,254.66 | |
| " | " 12/31/59 | 3,330,393.01 | 2,355,663.67 | |
| | Amortization | $ 84,248.47 | $ 59,590.99 | $143,839.46 |
| " | " 1/1/60 | $3,330,393.01 | $2,355,663.67 | |
| " | " 12/31/60 | 3,242,712.12 | 2,293,644.84 | |
| | Amortization | $ 87,680.89 | $ 62,018.83 | $149,699.72 |
| | | | TOTAL | $1,224,643.04 |

11 6. (a) During the calendar years 1958 and 1959 the petitioners received from The Berkshire, Inc., the totals of the amounts listed, respectively, under the headings: "Reported For D. C. Tax" and "Unreported For D. C. Tax", in the schedule following:

| | 1958 | | 1959 | |
|---|---|---|---|---|
| Petitioners | Reported For D. C. Tax | Unreported For D. C. Tax | Reported For D. C. Tax | Unreported For D. C. Tax |
| Hyman and Yetta D. Goldman | $1,999.54 | $5,000.46 | $3,189.74 | $5,210.26 |
| David L. Blanken | 399.91 | 1,000.09 | 637.95 | 1,042.05 |
| Edna R. Blanken | 457.03 | 1,142.97 | 729.09 | 1,190.91 |
| Leo and Goldyne Schlosberg | 1,428.24 | 3,571.76 | 2,278.40 | 3,721.60 |
| Benjamin Blanken | 457.03 | 1,142.97 | 729.09 | 1,190.91 |
| Faye B. Blanken | 399.91 | 1,000.09 | 637.95 | 1,042.05 |
| William and Ida Magazine | 1,142.58 | 2,857.42 | - o - | - o - |
| Ida Magazine | - o - | - o - | 911.36 | 1,488.64 |

| | | | | |
|---|---|---|---|---|
| Anne Gelfand | $ 285.65 | $ 714.35 | $ 455.68 | $ 744.32 |
| Herbert M. Gelfand | 285.65 | 714.35 | 455.68 | 744.32 |
| Meyer Gelfand and Herbert M. Gelfand, Executors of The Estate of Harry Gelfand and Sarah Gelfand | 1,713.89 | 4,286.11 | 2,734.06 | 4,465.94 |
| Meyer Gelfand | 1,713.89 | 4,286.11 | 2,734.06 | 4,465.94 |
| Aaron Goldman | 285.65 | 714.35 | - o - | - o - |
| Cecile S. Goldman | 1,428.24 | 3,571.76 | 2,278.40 | 3,721.60 |
| Esther M. Handleman | - o - | - o - | 455.68 | 744.32 |
| Meyer C. and Esther Handleman | 285.65 | 714.35 | - o - | - o - |
| Edward Zupnick | 1,428.24 | 3,571.76 | 2,278.40 | 3,721.60 |
| Fannie Zupnick | 1,428.24 | 3,571.76 | 2,278.40 | 3,721.60 |
| Joseph J. Zupnick | 1,428.24 | 3,571.76 | 2,278.40 | 3,721.60 |
| Irene Schlosberg | 1,428.24 | 3,571.76 | 2,278.40 | 3,721.60 |

(b) During calendar year 1960 the petitioners, David L. Blanken and Edna R. Blanken, received from The Berkshire, Inc. the totals, respectively, listed under the headings: "Reported for D. C. Tax" and "Unreported for D. C. Tax" as follows:

| | 1960 | |
|---|---|---|
| Petitioners | Reported For D. C. Tax | Unreported For D. C. Tax |
| David L. Blanken | $725.42 | $3,334.58 |
| Edna R. Blanken | 829.05 | 3,810.95 |

12

II

Queenstown Apartments

7. (a) The Queenstown Apartments project, as far as these cases are concerned, consisted of three separate corporations, namely, those owning and operating Sections A, B and E of a group of garden type apartment buildings located in nearby Prince Georges County, Maryland,

and hereinafter called "Queenstown Apartments". The only taxable year involved herein is the fiscal year that ended on September 30, 1959, as far as the petitioners are concerned, with the exception of David L. and Edna R. Blanken, whose 1960 taxes are herein involved.

(b) The entire capitalization of each corporation was 100 shares of preferred stock of the par value of $1.00 each, or a total par value of $100.00 and held by the mortgagee under the mortgage agreement; and 1,500 shares of common stock of the par value of $1.00 each, or a total for all the shares of $1,500.00.

8. The net earnings, after income taxes, distribution to stockholders, depreciation allowances claimed in income tax accounting and reporting and payments on mortgages in respect of the three sections of Queenstown Apartments were the following:

Section A, Inc.

| Fiscal Year Ended | Earnings After Taxes | Distribution on Common (Paid) | Depreciation Claimed | Principal Payments on Mtge. |
|---|---|---|---|---|
| 2/28/48 | ($15,930.30) | - o - | - o - | - o - |
| 2/28/49 | 3,167.67 | - o - | $39,450.48 | $ 7,224.80 |
| 2/28/50 | 10,860.37 | - o - | 40,444.52 | 22,223.35 |
| 2/28/51 | 630.13 | $49,004.45 | 40,244.52 | 23,071.21 |
| 12/31/51 | 2,377.70 | 9,000.00 | 33,735.90 | 19,896.99 |
| 1952 | ( 137.02) | 3,000.00 | 39,925.95 | 24,710.53 |
| 1953 | 312.74 | 9,000.00 | 39,917.46 | 25,653.26 |
| 1954 | ( 3,612.11) | 3,000.00 | 40,037.73 | 26,631.96 |
| 1955 | ( 10,038.94) | - o - | 40,080.28 | 27,647.99 |
| 1956 | ( 7,341.93) | - o - | 39,357.77 | 28,702.80 |
| 1957 | ( 454.97) | - o - | 38,279.41 | 29,797.87 |
| 1958 | 8,668.46 | - o - | 34,658.92 | 30,934.68 |
| 9/30/59 | 5,795.85 | 7,783.18 | 25,466.74 | 23,973.07 |

13

Section B, Inc.

| Fiscal Year Ended | Earnings After Taxes | Distribution on Common (Paid) | Depreciation Claimed | Principal Payments on Mtge. |
|---|---|---|---|---|
| 6/30/48 | ($12,723.43) | - o - | - o - | - o - |
| 6/30/49 | 17,835.25 | - o - | $27,506.77 | $ 8,331.92 |
| 2/28/50 | 6,797.66 | - o - | 23,468.22 | 13,604.40 |
| 2/28/51 | 5,022.61 | $54,355.75 | 35,115.14 | 21,054.05 |
| 12/31/51 | 4,726.88 | 9,000.00 | 29,269.20 | 18,157.33 |
| 1952 | 3,728.55 | 6,000.00 | 35,225.70 | 22,550.00 |
| 1953 | 4,472.06 | 13,000.00 | 35,225.70 | 23,410.32 |
| 1954 | 2,780.88 | 2,000.00 | 35,234.20 | 24,303.42 |
| 1955 | ( 4,045.27) | - o - | 35,273.33 | 25,230.65 |
| 1956 | ( 6,164.31) | - o - | 35,013.65 | 26,193.22 |
| 1957 | 2,239.28 | - o - | 33,824.63 | 27,192.52 |
| 1958 | 6,562.47 | - o - | 32,998.00 | 28,229.96 |
| 9/30/59 | 5,718.91 | 15,961.64 | 23,317.96 | 21,877.04 |

Section E, Inc.

| Fiscal Year Ended | Earnings After Taxes | Distribution on Common (Paid) | Depreciation Claimed | Principal Payments on Mtge. |
|---|---|---|---|---|
| 10/31/48 | ( 10,569.05) | - o - | - o - | - o - |
| 10/31/49 | 1,853.25 | - o - | $29,775.36 | $ 7,731.97 |
| 2/28/50 | 1,157.94 | - o - | 10,967.82 | 6,273.01 |
| 2/28/51 | 2,327.34 | $29,501.94 | 32,903.78 | 19,295.64 |
| 12/31/51 | 2,386.51 | 9,000.00 | 27,582.16 | 16,640.88 |
| 1952 | 1,374.21 | 5,000.00 | 32,903.78 | 20,666.66 |
| 1953 | 720.96 | 11,000.00 | 32,903.48 | 21,455.13 |
| 1954 | ( 2,735.60) | 2,000.00 | 32,911.46 | 22,273.68 |
| 1955 | ( 9,846.17) | - o - | 32,948.14 | 23,123.44 |
| 1956 | ( 5,946.42) | - o - | 32,930.28 | 24,005.64 |
| 1957 | 1,398.30 | - o - | 31,528.65 | 24,921.46 |
| 1958 | 7,790.02 | - o - | 31,293.99 | 25,872.27 |
| 9/30/59 | 5,363.26 | 15,002.05 | 21,683.51 | 20,049.93 |

9. (a) At the end of the fiscal year ended September 30, 1959, the depreciation reserves set up on the books and records of the three

Queenstown corporations were the following:

| Section A | Section B | Section E |
|---|---|---|
| $443,220.85 | $370,004.50 | $345,137.24 |

(b) With exception of small reserve funds deposited with the mortgagees as a deposit for interest and the like under the terms of the mortgage agreement, no fund was established to provide for depreciation. The amounts shown as representing depreciation were bookkeeping entries.

14 10. (a) For the fiscal year ended September 30, 1959, each of the three Queenstown Apartments corporations filed with the Internal Revenue Service reports of dividends paid on the form, U. S. ANNUAL INFORMATION RETURN, on which the corporations, respectively, reported or claimed that they had made to their stockholders the total distributions following:

| | | Section A | | | |
|---|---|---|---|---|---|
| Ordinary | Capital Distribution | Total | (1) Contribution To Sec. G | Net Cash |
| $5,790.85 | $1,992.33 | $7,783.18 | $3,553.51 | $4,229.67 |

| | | Section B | | |
|---|---|---|---|---|
| Ordinary | Capital Distribution | Total | Contribution To Sec. D | Net Cash |
| $5,713.91 | $10,247.73 | $15,961.64 | $9,164.50 | $6,797.14 |

(1) Evidently the stockholders of Sections A, B and E were the same in Sections D and G, and with the same proportionate holdings.

Section E

| Ordinary | Capital Distribution | Total | Contribution To Sec. G | Net Cash |
|---|---|---|---|---|
| $4,967.72 | $10,034.33 | $15,002.05 | $10,077.15 | $4,924.90 |

(b) The total amount distributed to the petitioners by the Queenstown corporations in the fiscal year ended September 30, 1959, were the following:

| 15 Petitioners | Section A | Section B | Section E |
|---|---|---|---|
| Benjamin Blanken | $108.96 | $223.46 | $210.02 |
| David L. Blanken | 108.96 | 223.46 | 210.02 |
| Edna R. Blanken | 124.53 | 255.38 | 240.02 |
| Faye Blanken | 124.53 | 255.38 | 240.02 |
| Yetta Goldman | 77.83 | 159.62 | 150.02 |
| Anne Gelfand | 77.83 | 159.62 | 150.02 |
| Estate of Harry Gelfand | 233.50 | 478.85 | 900.12 |
| Herbert M. Gelfand | 77.83 | 159.62 | 150.02 |
| Meyer Gelfand | 466.99 | 957.69 | 900.12 |
| Sarah Gelfand | 233.49 | 478.85 | - o - |
| Aaron Goldman | 77.83 | 159.62 | 150.02 |
| Cecile Goldman | 389.16 | 798.09 | 750.11 |
| Hyman Goldman | 466.99 | 957.69 | 900.12 |
| Esther M. Handleman | 77.83 | 159.62 | 150.02 |
| Ida Magazine | 155.67 | 319.23 | 300.04 |
| William Magazine | 155.66 | 319.23 | 300.04 |
| Goldyne Schlosberg | 389.16 | 798.09 | 750.11 |
| Irene Schlosberg | 389.16 | 798.09 | 750.11 |
| Edward Zupnik | 389.16 | 798.08 | 750.11 |
| Fannie Zupnik | 389.16 | 798.08 | 750.11 |
| Joseph J. Zupnik | 389.16 | 798.08 | 750.11 |

(c) The petitioners David L. and Edna R. Blanken in reporting taxable income for the year 1960 excluded the amounts received from the Queenstown Apartments corporations the amounts following:

David L. Blanken, $106.98 and Edna R. Blanken, $122.27.

(d) For the calendar year 1959 the petitioners excluded from taxable income in reporting taxable income that portion of the amounts received, by them, respectively, from the Queenstown Apartments corporations claimed by those corporations to be "Capital Distribution" in the reports of dividends mentioned in Finding No. 10(a).

III

The Assessments

11. The assessing authority of the District of Columbia determined that the entire amounts distributed by The Berkshire, Inc. and by the three Queenstown Apartments corporations were dividends of those corporations, and as such were taxable income, and assessed income taxes against petitioners for the years, on the dates and in the amounts following, and paid as follows:

| Petitioners | 1958 Tax | 1958 Interest | 1958 Total | Date Assessed | Date Paid |
|---|---|---|---|---|---|
| Hyman and Yetta D. Goldman | $191.12 | $27.71 | $218.83 | 8/18/61 | 9/15/61 |
| David L. Blanken | 35.00 | 5.08 | 40.08 | " | 9/7/61 |
| Edna R. Blanken | 25.72 | 3.73 | 29.45 | " | " |
| Leo and Goldyne Schlosberg | 125.08 | 18.14 | 143.22 | " | 10/4/61 |
| Irene Schlosberg | 162.11 | 23.51 | 185.62 | " | 10/9/61 |
| Benjamin Blanken | 45.51 | 6.60 | 52.11 | " | 9/15/61 |
| Faye B. Blanken | 25.00 | 3.63 | 28.63 | " | " |
| William and Ida Magazine | 121.44 | 17.61 | 139.05 | " | 9/11/61 |
| Anne Gelfand | 16.00 | 2.32 | 18.32 | " | 9/15/61 |
| Herbert M. Gelfand | 19.35 | 2.81 | 22.16 | " | 9/20/61 |
| Meyer Gelfand and Herbert M. Gelfand, Executors Of The Estate Of Harry Gelfand and Sarah Gelfand | 191.35 | 27.75 | 219.10 | " | 9/26/61 |

| | | | | | |
|---|---|---|---|---|---|
| Meyer Gelfand | 214.31 | 31.07 | 245.38 | 8/18/61 | 9/26/61 |
| Aaron Goldman | 35.72 | 5.18 | 40.90 | " | 9/15/61 |
| Cecile S. Goldman | 125.01 | 18.13 | 143.14 | " | " |
| Meyer C. and Esther Handleman | 30.08 | 4.36 | 34.44 | " | 9/14/61 |
| Edward Zupnik | 60.84 | 8.82 | 69.66 | 9/8/61 | 9/15/61 |
| Fannie Zupnik | 99.71 | 14.46 | 114.17 | 8/18/61 | " |
| Joseph J. Zupnik | 125.02 | 18.13 | 143.15 | " | " |

1959

| Petitioners | Tax | Interest | Total | Date Assessed | Date Paid |
|---|---|---|---|---|---|
| Hyman and Yetta D. Goldman | $274.58 | $27.46 | $302.04 | 11/13/61 | 11/17/61 |
| David L. Blanken | 54.15 | 4.60 | 58.75 | 8/18/61 | 9/7/61 |
| Edna R. Blanken | 40.61 | 3.45 | 44.06 | " | " |
| Leo and Goldyne Schlosberg | 214.58 | 18.24 | 232.82 | " | 10/4/61 |
| Irene Schlosberg | 220.92 | 18.78 | 239.70 | " | 10/9/61 |
| Benjamin Blanken | 59.42 | 5.05 | 64.47 | " | 9/15/61 |
| Faye B. Blanken | 35.74 | 3.04 | 38.78 | " | " |
| Ida Magazine | 49.32 | 4.19 | 53.51 | " | 9/11/61 |
| Anne Gelfand | 22.50 | 1.91 | 24.41 | " | 9/15/61 |
| Herbert M. Gelfand | 24.17 | 2.05 | 26.22 | " | 9/20/61 |
| Meyer Gelfand and Herbert M. Gelfand, Executors Of The Estate Of Harry Gelfand and Sarah Gelfand | 238.80 | 20.30 | 259.10 | " | 9/26/61 |
| Meyer Gelfand | 12.21 | 1.04 | 13.25 | " | " |
| Cecile S. Goldman | 225.85 | 19.20 | 245.05 | " | 9/15/61 |
| Esther M. Handleman | 24.18 | 2.06 | 26.24 | " | 9/14/61 |
| Edward Zupnik | 128.37 | 10.91 | 139.28 | 9/8/61 | 9/15/61 |
| Fannie Zupnik | 150.85 | 12.82 | 163.67 | 8/18/61 | " |
| Joseph J. Zupnik | 176.51 | 15.00 | 191.51 | " | " |

1960

| Petitioners | Tax | Interest | Total | Date Assessed | Date Paid |
|---|---|---|---|---|---|
| David L. Blanken | $110.51 | $3.87 | $114.38 | 10/30/61 | 11/9/61 |
| Edna R. Blanken | 106.45 | 3.73 | 110.18 | " | " |

12. These cases were filed on November 15, 1961.

17 Opinion

The petitioners are residents of the District of Columbia and are common stockholders of a corporation, The Berkshire, Inc., and three other corporations, namely, Queenstown Apartments, Section A, Inc., Queenstown Apartments, Section B, Inc. and Queenstown Apartments, Section E, Inc., hereinafter called "Section A, Inc.", "Section B, Inc." and "Section E, Inc.",(2) respectively. The Berkshire, Inc. is the owner and operator of a large apartment in Washington, D. C. known as "the Berkshire". The three Queenstown Apartments corporations are owners and operators of three sections of a large garden type apartment project in Prince Georges County, Maryland.

With the exception of 100 shares of preferred stock of the par value of $1.00 a share held by the mortgagees of the properties, the entire capitalization, that is to say, the total amount paid in as capital by the stockholders of the four corporations, respectively, was as follows:

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| The Berkshire, Inc. | 500 | shares, | par | value | $1.00 | per | share, | or | $ 500.00 |
| Section A, Inc. | 1500 | " | " | " | " | " | " | " | 1500.00 |
| Section B, Inc. | 1500 | " | " | " | " | " | " | " | 1500.00 |
| Section E, Inc. | 1500 | " | " | " | " | " | " | " | 1500.00 |

The operation of the apartment buildings has been successful.

(2) There is indication in the record that they are stockholders of Queenstown Apartments, Section D, Inc. and Queenstown Apartments, Section G, Inc. Those corporations, however, are not involved in these cases.

In the eight or nine years of operation, terminating with the year 1960, The Berkshire, Inc. reduced the first mortgages on the two sections of the Berkshire by $1,224,643.04, redeemed its second preferred stock in the amount of $243,500, and paid off an ordinary loan of approximately $250,000.(3) In the three taxable years involved (1958, 1959 and 1960) The
18 Berkshire, Inc. paid, or made distributions to its common stockholders of a total amount in excess of $500,000.

The Queenstown Apartments corporations in 1959 (the only year involved) reduced the mortgages on their three buildings by these amounts: Section A, by $23,973.07; Section B, by $21,877.04; and Section E, by $20,049.93. In the twelve years of the operation of the units, terminating in 1959, the mortgages thereon were reduced by the following amounts:

Section A - - - $290,468.51
Section B - - - $260,134.83
Section E - - - $232,309.71

The sole question presented in these cases is whether the entire amount of money distributed by the four corporations to the petitioners were taxable dividends under Section 4(m) of Title I of the District of Columbia Income and Franchise Tax Act of 1947 (Section 47-1551c (m), D. C. Code, 1961 Edition), which reads in part as follows:

(3) The testimony of the petitioner's witnesses indicate that the second preferred stock and loan, which were redeemed and paid off, totalled $500,000. The income tax returns of the petitioner show the second preferred stock to have been in the amount of $243,500.

> "The word 'dividend' means any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits, or surplus (other than paid in surplus), whenever earned by the corporation and whether made in cash or any other property (other than stock of the same class in the corporation if the recipient of such stock dividend has neither received nor exercised an option to receive such dividend in cash or in property other than stock instead of stock) and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation: * * *"

It should here be observed that the key phrase in the definition of "depreciation" ["dividend"] is "whenever earned by the corporation". Unless the cash or other property distributed to stockholders was earned, the distribution is not a "dividend" within the meaning of the quoted definition. District of Columbia v. Oppenheimer, _____ U. S. App. D. C. _____, _____ F. 2d _____, 90 W. L. R. 599 (decided March 22, 1962).

19 The petitioners claim that a portion of the amounts distributed to them by the four corporations were payments from depreciation reserves and were capital distribution, and not earned by the corporations; and that such portions, therefore, were not taxable income under the Act. The petitioners in their returns actually included in gross income portions of the distributions in the computation of the income taxes. They excluded the remaining portions of the distribution. The assessing authority of the District of Columbia determined or ruled that the entire amounts of the distribution was taxable, and accordingly assessed

deficiencies in income tax against the petitioners. Those deficiencies are the subject matter of these cases. The solution of the problem thus presented requires consideration of some well established principles in the law of income taxation.

"Depreciation" is defined in Lindheimer v. Illinois Bell Telephone Co., 292 U.S. 150, 167, 78 L. Ed. 1182, 54 S. Ct. 658, in this manner.

> "Broadly speaking, depreciation is the loss, not restored by current maintenance which is due to all factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence.
>
> "* * * According to the practice of the company, the depreciation reserve is not held as a separate fund, but is invested in plant and equipment. As the allowance for depreciation, credited to the depreciation reserve account, are charged to operating expenses, the depreciation reserve invested in the property thus represents, at a given time, the amount of the investment, which has been made out of the proceeds of telephone rates for the ostensible purpose of replacing capital consumed, * * *."

One principle that is well fixed in the law of income taxation is that the distribution from depreciation reserves constitutes a distribution of capital and not of earnings. The other principle is equally important. It is that a corporation cannot distribute to its stockholders depreciation reserves as long as it has accumulated earnings and profits. In other words, the earnings and profit must first be used or exhausted by the payment of dividends. The two rules are clearly stated in John K.

Beretta, 1 T.C. 86, 99 (affirmed 141 F. 2d 452, cert. den. 323 U.S. 720) as follows:

> "It is true, of course, that a distribution by a corporation to its stockholders of its depreciation reserve is not a taxable dividend and would be applied to a reduction in the cost basis of the stock. This is true because a depreciation reserve represents a return of capital. However, it must be borne in mind that under Section 115(b), supra, for the purposes of taxation effect, a corporation can not distribute to its stockholders its depreciation reserve as long as it has earnings and profits accumulated after February 28, 1913, sufficient to cover the distribution in question."

The foregoing from John K. Beretta was quoted with approval in Douglas Hotel Co., 14 T.C. 1136, 1142 (affirmed, 190 F. 2d 766), after the following statement:

> "Depreciation or depletion reserves are generally regarded as partaking of the nature of capital, since they represent a portion of the cost of the assets used in the business. Therefore, distributions from such reserves have been held to constitute distributions of capital rather than of income. See Creamette Co. 37 B.T.A. 216; Ida I. McKinney, 32 B.T.A. 450; affd., 87 F.(2d) 811; John K. Beretta, 1 T.C. 86; affd., 141 F.(2d) 452; certiorari denied, 323 U.S. 720. * * *"

A recent case, and one in which there was involved apartment house projects similar to those with which we are here concerned, is George M. Gross, 23 T.C. 756, wherein at page 772 is found the following:

"The distributions by the four Mars Homes corporations were, it is stipulated, out of depreciation reserves. Depreciation reserves are generally regarded as of the nature of capital, representing a part of the cost of the assets used in the business, and distributions from such reserves have been held to constitute distributions of capital rather than income. Douglas Hotel Co., 14 T. C. 1136 (1950), affd. (C. A. 8, 1951) 190 F. 2d 766; John K. Beretta, 1 T. C. 86 (1942), affd. (C. A. 5, 1944) 141 F. 2d 462, certiorari denied 323 U. S. 720. * * *"

The facts to which the foregoing principles must be applied must now be discussed:

21 The Berkshire, Inc.

It is clear from the record that the corporation intended from its beginning to make distributions to its stockholders in part from earnings and in part as a return of capital. At the end of 1953 it had distributed to them more than $350,000, while its cumulative deficit was slightly more than $300,000, representing the excess of distributions over cumulative earnings after taxes. Apart from its historical significance, the foregoing is not here important. It should, however, be here observed, that the amortization or reduction of payments on the mortgages encumbering the Berkshire were made out of the depreciation reserves, which were ample for that purpose, and appropriate as well, since they must be considered as capital and the logical asset from which the capital expenditure of amortization or reduction of mortgages could be made.

Because of subsequent events in the corporations' fiscal history, the "cut-off" date is the end of 1953. During the years 1954, 1955 and 1956 no distributions were made to the stockholders. The earnings were as follows:

| Year | Before Income Taxes | Income Taxes | Net Earnings After Income Taxes |
|---|---|---|---|
| 1954 | $103,573.16 | $48,358.04 | $ 55,215.12 |
| 1955 | 80,128.99 | 36,167.07 | 43,961.92 |
| 1956 | 80,989.68 | 36,954.98 | 44,034.20 |
| | | Total | $143,211.74 |

Distributions to stockholders was resumed in 1957. The net earnings that were first available for the payment of dividends were the accumulated net earnings of $143,211.74, plus the net earnings after income taxes for the year 1957 of $36,552.11. (Profit, $64,691.90, less income taxes, $28,139.79) making a total of earnings, which were first to be used for dividends, $179,763.85. The distribution of 1957 in the amount of $75,000 to the common stockholders was, therefore, a dividend, and was fully taxable.

22 The dividends of $75,005,(4) distributed in 1957, left available for dividends in 1958 the amount of $104,758.85 ($179,753.85 - $75,005). To this sum was added the net earnings after income taxes for 1958 of $29,418.54 (Profit, $61,769.95, less income taxes, $32,351.41) making a total of net earnings thus available in that year of $134,177.39. In 1958 a

(4) The $5 dividend was on the first preferred stock of $100.

distribution of $100,000 was made to the common stockholders, and $5 to the first preferred stockholder, making a total distribution of $100,005. The distribution to the common stockholders was a dividend and, therefore, was fully taxable. The deficiencies in income assessed against the petitioners to the extent they were based upon the dividend paid by The Berkshire, Inc. for the year 1958 were valid.

The distribution or dividends of $100,005 in 1958 left remaining accumulated net earnings after taxes of $34,172.39 ($134,177.39 - $100,005) available for the payment of dividends in 1959. That amount was augmented by the net earnings after taxes of $45,580.89 (Profit, $83,493.25 - income taxes, $37,912.36) and by a refund of income taxes in the amount of $1,201.79, making a total of $80,955.07 available for the payment of dividends. In 1959 the corporation distributed to its stockholders $120,005. Of that amount $39,049.93 was from the reserve for depreciation, and, therefore, capital. Since the amount of $39,049.93 was not earned, the distribution to that extent was not taxable. District of Columbia v. Oppenheimer, supra.

There was no carry-over to 1960, or deduction from net earnings of that year of the amount distributed from depreciation reserves in 1959. All that happened in 1959 was that the corporation distributed to its stock-
23 holders $80,955.07 from its earnings and $39,049.93 from its depreciation reserve. The amount of $39,049.93 did not have to be taken

out of net earnings for 1960 before such earnings could be used to pay dividends.

In 1960 the corporation distributed to its stockholders dividends in the total amount of $290,005. Its earnings after income taxes were $52,323.89 (Profit, $97,004.70 - income taxes, $44,680.81). That amount only was available for the payment of dividends. The balance of the distribution amounting to $237,681.11 was from depreciation reserves, was a capital distribution and was non-taxable.

Queenstown Apartments

The three Queenstown Apartments corporations made distributions to their stockholders in 1954. Apparently those distributions were from depreciation reserves. There were no earnings, either current or accumulated, available therefor. No distributions were made to stockholders for the fiscal years ended September 30, 1955 to 1958, inclusive. There were no earnings after income for the three corporations for the fiscal years ended September 30, 1955 and 1956. Section A, Inc. had no such earnings for 1957, but Section B, Inc. and Section E, Inc. did have earnings after income taxes for the fiscal year ended September 30, 1957. All three had earnings after income taxes for the fiscal years ended September 30, 1958 and 1959.

As was the case of The Berkshire, Inc. depreciation reserves were more than sufficient, and were used to pay for the reduction of mortgages on the three apartment buildings.

We are concerned here with distributions made by the three corporations during the fiscal year ended September 30, 1959. Operation of the project during the prior years must be considered, however, to
24 determine the character of the distributions made to their stockholders. Such operation, graphically stated, for the determinative years is the following:

Section A

| Fiscal Year Ended September 30 | Earnings After Income Taxes | Distribution To Common Stockholders |
|---|---|---|
| 1958 | $ 8,668.46 | None |
| 1959 | 5,795.85 | $ 7,783.18 |
| Total | $14,464.31 | |

Section B

| | | |
|---|---|---|
| 1957 | $ 2,239.28 | None |
| 1958 | 6,562.47 | None |
| 1959 | 5,718.91 | $15,961.64 |
| Total | $14,510.66 | |

Section E

| | | |
|---|---|---|
| 1957 | $ 1,398.30 | None |
| 1958 | 7,790.02 | None |
| 1959 | 5,363.26 | $15,002.00 |
| Total | $14,541.58 | |

It will be seen from the foregoing that there were earnings, current and accumulated, after income taxes sufficient for the payments of dividends in amounts in excess of the distributions made in the fiscal year ended September 30, 1959, by Section A, Inc. and Section B, Inc.

Such distributions were dividends and are taxable income to the petitioners.

The earnings, current and accumulated, after income taxes of Section E, Inc. amounted to $14,541.58. The distribution made to the common stockholders in the fiscal year ended September 30, 1959, amounted to $15,002.05, which was $460.47 in excess of the available earnings. With the exception of that last mentioned sum, the amounts distributed to the common stockholders were dividends, and were taxable to the petitioners, respectively.

25 CONCLUSION

For the reasons stated the Court holds as follows:

The Berkshire, Inc.

(a) The amounts distributed by The Berkshire, Inc. to its common stockholders in 1958 (Total $100,000) were dividends, and were taxable to the petitioners respectively.

(b) The amounts distributed to the common stockholders in 1959, totaling $80,955.07, were dividends, and were taxable to the petitioners, respectively. The balance of the distribution made in 1959 was from depreciation reserves, and were non-taxable.

(c) The amounts distributed to the common stockholders in 1960, totaling $52,323.89, were dividends, and were taxable pro rata to the petitioners David L. Blanken and Edna R. Blanken, respectively. The

balance of the distribution made in 1960 was from depreciation reserves, and were non-taxable.

Queenstown Apartments

(a) The amounts distributed to their common stockholders in the fiscal year ended September 30, 1959, by Section A, Inc. and Section B, Inc. were dividends and were taxable to the petitioners, respectively.

(b) The amounts, totaling $14,541.58, distributed by Section E, Inc. to its common stockholders in the fiscal year ended September 30, 1959, were dividends, and were taxable to the petitioners, respectively. The amounts totaling $460.47, distributed to its stockholders were not dividends, but were capital distributions and non-taxable.

Decisions will be entered under Rule 30.

/s/ Jo V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

FILED
May 21, 1962

| | | |
|---|---|---|
| HYMAN GOLDMAN AND YETTA GOLDMAN, ET AL, Petitioners | ) | |
| v. | ) | Docket Nos. 1761-1780 (inclusive) |
| DISTRICT OF COLUMBIA, Respondent | ) | |

MOTION FOR RECONSIDERATION

Pursuant to Rule 12(e) of the Rules of Procedure, the petitioners move this Honorable Court to reconsider its opinion filed herein May 8, 1962. The grounds for this motion are as follows:

1. The petitioners submit that with respect to distributions received by them in 1959 from the various Queenstown corporations, the principles of law found to be applicable to this case by the Court, require a different conclusion as to the taxability of the said distributions.

2. That although Finding of Fact No. 8 reflects no earnings of any of the Queenstown corporations after September 30, 1959 and Finding of Fact No. 10(c) states that petitioners David L. and Edna R. Blanken excluded certain distributions received by them in 1960 from gross income, the Court's opinion and conclusions make no specific ruling as to the taxability of these amounts. It is respectfully submitted that the applicable principles of law entitle these petitioners to a further ruling that the distributions received by them from the two Queenstown corporations in 1960 are to be excluded from taxable income.

Petitioners submit herewith a memorandum setting forth in detail the basis for their present motion.

* * *

OPINION NO. 996(A)

FILED
June 11, 1962

DISTRICT OF COLUMBIA TAX COURT

## AMENDMENT TO THE FINDINGS OF FACT AND OPINION

The petitioners have filed a motion for reconsideration of the Court, which has been answered by the respondent. After consideration thereof the Court makes the following amendments:

### FINDING OF FACT

The Findings of Fact are amended by including the paragraph following:

"9. (c) The distribution to the stockholders of the Queenstown corporation in 1960 were made after the corporation had discontinued business, and were from the reserve funds deposited with mortgagees, and mentioned in paragraph 9(b) hereof."

### OPINION

The Opinion is amended by striking out the following:

"Section A

| Fiscal Year Ended September 30 | Earnings After Income Taxes | Distribution To Common Stockholders |
|---|---|---|
| 1958 | $8,668.46 | None |
| 1959 | 5,795.85 | $7,783.18 |
| Total | $14,464.31 | |

Section B

| | | |
|---|---|---|
| 1957 | $2,239.28 | None |
| 1958 | 6,562.47 | None |
| 1959 | 5,718.91 | $15,961.64 |
| Total | $14,510.66 | |

Section E

| | | |
|---|---|---|
| 1957 | $1,398.30 | None |
| 1958 | 7,790.02 | None |
| 1959 | 5,363.26 | $15,002.00 |
| Total | $14,541.58 | |

"It will be seen from the foregoing that there were earnings, current and accumulated, after income taxes sufficient for the payments of dividends in amounts in excess of the distributions made in the fiscal year ended September 30, 1959, by Section A, Inc., and Section B, Inc. Such distributions were dividends and are taxable income to the petitioners.

"The earnings, current and accumulated, after income taxes of Section E, Inc., amounted to $14,541.58. The distribution made to the common stockholders in the fiscal year ended September 30, 1959, amounted to $15,002.05, which was $460.47 in excess of the available earnings. With the exception of that last mentioned sum, the amounts distributed to the common stockholders were dividends, and were taxable to the petitioners, respectively."

And by substitution in lieu thereof the following:

| YEAR ENDED | EARNINGS AFTER TAXES | DISTRIBUTIONS ON COMMON (PAID) | CUMULATIVE NET OPERATING LOSS |
|---|---|---|---|
| | | **SECTION A, INC.** | |
| 2/28/48 | $(15,930.30) | $ - - | $(15,930.30) |
| 2/28/49 | 3,167.67 | - - | (12,762.63) |
| 2/28/50 | 10,860.37 | - - | (1,902.26) |
| 2/28/51 | 630.13 | 49,004.45 | (1,902.26) |
| 12/31/51 | 2,377.70 | 9,000.00 | (1,902.26) |
| 1952 | (137.02) | 3,000.00 | (2,039.28) |
| 1953 | 312.74 | 9,000.00 | (2,039.28) |
| 1954 | (3,612.11) | 3,000.00 | (5,651.39) |
| 1955 | (10,038.94) | - - | (15,690.33) |
| 1956 | (7,341.93) | - - | (23,032.26) |
| 1957 | (454.97) | - - | (23,487.23) |
| 1958 | 8,668.46 | - - | (14,818.77) |
| 9/30/59 | 5,795.85 | 7,783.18 | (14,818.77) |
| | | **SECTION B, INC.** | |
| 6/30/48 | (12,723.43) | - - | (12,723.43) |
| 6/30/49 | 17,835.25 | - - | 5,111.82 |
| 2/28/50 | 6,797.66 | - - | 11,909.48 |
| 2/28/51 | 5,022.61 | 54,355.75 | - - |
| 12/31/51 | 4,726.88 | 9,000.00 | - - |
| 1952 | 3,728.55 | 6,000.00 | - - |
| 1953 | 4,472.06 | 13,000.00 | - - |
| 1954 | 2,780.88 | 2,000.00 | 780.88 |
| 1955 | (4,045.27) | - - | (3,264.39) |
| 1956 | (6,164.31) | - - | (9,428.70) |
| 1957 | 2,239.28 | - - | (7,189.42) |
| 1958 | 6,562.47 | - - | ( 626.95) |
| 9/30/59 | 5,718.91 | 15,961.64 | ( 626.95) |
| | | **SECTION E, INC.** | |
| 10/31/48 | (10,569.05) | - - | (10,569.05) |
| 10/31/49 | 1,853.25 | - - | (8,715.80) |
| 2/28/50 | 1,157.94 | - - | (7,557.86) |
| 2/28/51 | 2,327.34 | 29,501.94 | (7,557.86) |
| 12/31/51 | 2,386.51 | 9,000.00 | (7,557.86) |

| | | | |
|---|---|---|---|
| 1952 | 1,374.21 | 5,000.00 | (7,557.86) |
| 1953 | 720.96 | 11,000.00 | (7,557.86) |
| 1954 | (2,735.60) | 2,000.00 | (10,293.46) |
| 1955 | (9,846.17) | - - | (20,139.63) |
| 1956 | (5,946.42) | - - | (26,086.05) |
| 1957 | 1,398.30 | - - | (24,687.75) |
| 1958 | 7,790.02 | - - | (16,897.73) |
| 9/30/59 | 5,363.26 | 15,002.05 | (16,897.73) |

"It will be seen from the foregoing that for fiscal year ended September 30, 1959, which is the only taxable year here involved, the operating deficit (after taxes) of the three Queenstown corporations was greater than the distributions to stockholders, respectively, in other words there was an impairment of capital represented by the deficits. There were earnings, however, for the years 1957, 1958 and 1959 and, compared with the distributions to stockholders, were as follows:

Section A

| Fiscal year Ended September 30 | Earnings after Income Taxes | Distribution To Common Stockholders |
|---|---|---|
| 1958 | $8,668.46 | None |
| 1959 | 5,795.85 | $7,783.18 |
| Total | $14,464.31 | |

Section B

| | | |
|---|---|---|
| 1957 | $2,239.28 | None |
| 1958 | 6,562.47 | None |
| 1959 | 5,718.91 | $15,961.64 |
| Total | $14,510.66 | |

Section E

| | | |
|---|---|---|
| 1957 | $1,398.30 | None |
| 1958 | 7,790.02 | None |
| 1959 | 5,363.26 | $15,002.00 |
| Total | $14,541.58 | |

"The question which presents itself at this point is whether the impairment of capital occasioned by the operating deficit had to be restored before there could be earnings available for dividends, with the corollated question whether there could be any 'dividends' since the corporations discontinued business after the fiscal year ended September 30, 1959.

"The decisions of the United States Tax Court appear to lack consistency. Study of those authorities indicate that the differences are for the most part due to a change in the Internal Revenue Code relating to 'dividends'. In the 1934 and prior Revenue Acts the term 'dividend' was defined as follows:

> SEC. 115. DISTRIBUTIONS BY CORPORATIONS.
> (2) DEFINITION OF DIVIDEND. - The term 'dividend' when used in this title (except in section 203 (a) (4) and section 207 (c) (1), relating to insurance companies) means any distribution made by a corporation to its stockholders, whether in money or in property, out of its earnings or profits accumulated after February 28, 1913. Emphasis supplied.

"In the Revenue Act of 1936 and in subsequent Revenue Acts the definition was materially changed. It read:

> SEC. 115. DISTRIBUTIONS BY CORPORATIONS.
>
> (a) DEFINITIONS OF DIVIDEND. - The term 'dividend' when used in this chapter * * * means any distribution made by a corporation to its shareholders, whether in money or in other property, (1) out of its earnings or profits accumulated after February 28, 1913, or (2) out of the earnings or profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made, * * *.

"The decisions of the Federal Courts and of the United States Tax Court are fairly consistent in cases involving years prior to 1936. They hold, as stated in Merten's Law of Federal Income Taxation, Section 9.30, that 'In case of corporations organized after February 28, 1913, the accumulated earnings and profits or the accumulated deficit is the net difference for the period from date of organization to distribution year between the deficits of the loss years and the earnings of the profit years. An impairment of fixed or statutory capital occasioned by a deficit must be restored out of subsequent earnings before there can be accumulated earnings or profits available for dividends.' Willcuts v. Milton Dairy Co. 275 U.S. 215, 72 L.Ed. 247, 48 S.Ct. 71; Foley Securities Corp. 106 F.2d 731; Commissioner v. Farrish, 104 F.2d 833; Hadden v. Commissioner, 49 F.2d 709; Lich v. United States Rubber Co., 39 F. Supp. 675; Van Norman v. Welch, 141 F.2d 99; Roy J. Kinnear, 36 B.T.A. 153; Edna C. Gutman 45 B.T.A. 836; Loren D. Sale 35 B.T.A. 938; Estate of Harold M. Lehman 4 T.C. 325.

"It should here be noted that in Edna C. Gutman, supra, and Estate of Harold M. Lehman, supra, the decisions were based on the premise that the determinative period brought the solution of the question there involved under the Revenue Act of 1934, and inferred, or indicated that had the Revenue Act of 1936 applied the result would have been different.

"F.W. Henninger, 21 B.T.A. 1235, was under the Revenue Act of 1924, and at first blush, appears to hold contrary to the above authorities, in that it held that earnings and profits did not have to make good impairment of capital before dividends could be paid. The impairment of capital, however, in that case was not due to operating losses, but was what happened in respect of The Berkshire, Inc., and which distinguishes that phase of the case from this part.

"The later cases in the United States Tax Court, that is to say, cases decided under the Revenue Act of 1936 and under subsequent Acts do not follow the earlier cases. For instance, in William G. Maguire, 21 T.C. 853, 854 (5) is found this language:

> 'The petitioner concedes that if any part of the distributions was taxable as a dividend, then the amount determined by the Commissioner is correct. He contends, however, that no part of the distributions was taxable as a dividend because the earnings for the year 1945 did not

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(5) Reversed on another point, Maguire v. Commissioner, 222 F.2d 472.

wipe out the deficit, and a corporation can not declare and pay a taxable dividend as long as it has a deficit. That contention is directly contrary to the provisions of section 115 (a) (2) applicable to 1945 defining a dividend to include any distribution made by a corporation to its stockholders out of the earnings or profits of the taxable year. Congress first defined dividends to include earnings or profits of the current year in the Revenue Act of 1936. The Senate Finance Committee report (S. Rept. No. 2156, 74th Cong., 2d Sess. (1936), p. 18) declared the purpose of the expansion of the definition to be 'to enable corporations without regard to deficits existing at the beginning of the taxable year to obtain the benefit of the dividends-paid credit for the purposes of the undistributed-profits surtax.' The provision was not thereafter changed. The Commissioner, in his regulations, interpreted the definition to include earnings or profits of the taxable year regardless of whether the corporation had a deficit at the beginning of the year. Regs. 111, sec. 29.115-1. The argument of the petitioner in this connection is rejected. Ratterman v. Commissioner, 177 F.2d 204. Cf. Helvering v. Alworth Trust, 136 F.2d 812, certiorari denied 320 U.S. 784; Edna C. Gutman, 45 B.T.A. 836; Estate of Harold M. Lehman, 4 T.C. 325.'

"Later in Stanley v. Waldheim, 25 T.C. 839, 849, the ruling, pertinent here, was the following:

> 'The facts show that at December 31, 1944, Waldheim & Company had a deficit of $21,577.26 and though it did have substantial net earnings in 1945, it would still have had a deficit at December 31, 1945, even if no distributions to stockholders had been made. On such facts it is the claim of the petitioners that no part of the distributions could have been dividends. The claim is not well taken. Waldheim & Company did have net earnings for 1945 substantially in excess of the cash distributions made pro rata to its stockholders in that year, and under clause (2) of section 115 (a) quoted above, those distributions were dividends.

William G. Maguire,[6] 21 T.C. 853. The cases cited and relied on by petitioners either relate to years prior to the enactment of clause (2) above or are otherwise distinguishable.'

"See also Commissioner v. Kelham, 192 F.2d 785, reversing Grace H. Kelham,[7] 13 T.C. 984.

"The Court believes that the District of Columbia provision defining the term 'dividend' more nearly approaches the Revenue Act of 1936 and subsequent Acts than it does the Revenue Act of 1934 and prior Acts. It will be noted that the term 'dividend'in the Revenue Act of 1936, includes the distribution to shareholders of any earnings made by the distributing corporation during the taxable year, upon which provision the opinions in the United States Tax Court turned. The District of Columbia definition includes earnings of the distributing corporation 'whenever earned'.

"The District of Columbia definition includes both 'earnings' and 'profits'. As was said in Lich v. United States Rubber Co., supra, 'The term net profits is not synonymous with net earnings. Annual net earnings may be productive of net profits, or, as in the instant case, reductive of the deficit'. The Queenstown corporations may not have

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(6) Willcuts v. Milton Dairy Co., 275 U.S. 215; Foley Securities Corporation v. Commissioner, 106 F.2d 781; Hadden v. Commissioner, 49 F.2d 709; Estate of Harold M. Lehman, 4 T.C. 325; Roy J. Kinnear, 36 B.T.A. 153; and Edna C. Gutman, 45 B.T.A. 836.

(7) The companion case of Adolph B. Spreckels, 13 T.C. 1079, was reversed on stipulation to abide by the final judgment in the Kelham case.

had any net profits at the time of the distributions, but they did have undistributed earnings, 'whenever earned', and available for the payments of dividends.

"The Court, therefore, is of the opinion that the distributions made by the Queenstown corporations to the petitioners were dividends to the extent that the corporation had undistributed earnings which were earned during the years 1957, 1958 and 1959.

"Section A had available earnings of $14,464.31 and distributed to its stockholders $7,783.18. The entire amount of the distribution was a dividend. Section B had available earnings of $14,510.66 and distributed $15,961.64, which was in excess of earnings by $1,450.98. Section E had available earnings of $14,541.58 and distributed $15,002.00, which was in excess of earnings by $460.42."

The opinion is further amended by striking out the last two paragraphs thereof, under the heading, "Queenstown Apartments" and substituting in lieu thereof the following:

"Queenstown Apartments

"(a) The amounts distributed to its common stockholders in the fiscal year ended September 30, 1959, by Section A, Inc. were dividends, and were taxable to the petitioners, respectively.

"(b) The amounts totaling $14,510.66 distributed by Section B, Inc. to its common stockholders in the fiscal year ended September 30, 1959, were dividends, and were taxable to the petitioners, respectively. The amounts totaling $1,450.98 distributed to its stockholders were not dividends, but were capital distributions and non-taxable.

"(c) The amounts, totaling $14,541.58, distributed by Section E, Inc. to its common stockholders in the fiscal year ended September 30, 1959, were dividends, and were taxable to the petitioners, respectively. The amounts totaling $460.47, distributed to its stockholders were not dividends, but were capital distributions and non-taxable.

"(d) The amounts distributed by the Queenstown corporations to the petitioners, David L. Blanken and Edna R. Blanken, during the fiscal year ended September 30, 1960, were capital distributions and non-taxable."

Decision will be entered under Rule 30.

DISTRICT OF COLUMBIA TAX COURT

HYMAN GOLDMAN and
YETTA D. GOLDMAN,

Petitioners,

vs.

DISTRICT OF COLUMBIA,

Respondent.

FILED
June 26, 1962

Docket No. 1761

# D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is, by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $191.12 was validly assessed and collected from the petitioners and they are not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $121.01 plus interest of $12.10, or a total of $133.11, was erroneously assessed and collected from the petitioners; and that the petitioners are entitled to interest thereon at the rate of 4 per centum per annum from November 17, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| DAVID L. BLANKEN, | ) | FILED June 26, 1962 |
| Petitioner, | ) | |
| vs. | ) | Docket No. 1762 |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $35.00 was validly assessed and collected from the petitioner and he is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $22.93 plus interest of $1.95, or a total of $24.88, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 7, 1961, to the date of payment of refund,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1960 in the amount of $110.51 plus interest of $3.87, or a total of $114.38, was erroneously assessed and

collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from November 9, 1961, to date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| EDNA R. BLANKEN, | ) | FILED |
| | ) | June 26, 1962 |
| Petitioner, | ) | |
| vs. | ) | Docket No. 1763 |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $25.72 was validly assessed and collected from the petitioner and she is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $16.38 plus interest of $1.39, or a total of $17.77, was erroneously assessed and

collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 7, 1961, to the date of payment of refund,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1960 in the amount of $106.45 plus interest of $3.73, or a total of $110.18, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from November 9, 1961, to date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| LEO SCHLOSSBERG and GOLDYNE SCHLOSSBERG, Petitioners, | ) | FILED June 26, 1962 |
| vs. | ) | Docket No. 1764 |
| DISTRICT OF COLUMBIA, Respondent. | ) | |

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is, by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $125.08 was validly assessed and collected from the petitioners and they are not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $81.92 plus interest of $6.96, or a total of $88.88, was erroneously assessed and collected from the petitioners; and that the petitioners are entitled to interest thereon at the rate of 4 per centum per annum from October 4, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

IRENE SCHLOSBERG, )
Petitioner, )
vs. ) Docket No. 1765
DISTRICT OF COLUMBIA, )
Respondent. )

FILED
June 26, 1962

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing

on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $162.11 was validly assessed and collected from the petitioner and she is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $102.40 plus interest of $8.70, or a total of $111.10, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from October 9, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| BENJAMIN BLANKEN, | ) | FILED |
| | | June 26, 1962 |
| Petitioner, | ) | |
| vs. | ) | Docket No. 1766 |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing

on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $45.51 was validly assessed and collected from the petitioner and he is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $26.06 plus interest of $2.22, or a total of $28.28, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 15, 1961, to the date of payment of refund.

/s/ Jo. V.

DISTRICT OF COLUMBIA TAX COURT

FAYE B. BLANKEN, )
Petitioner, )
vs. ) Docket No. 1767
DISTRICT OF COLUMBIA, )
Respondent. )

FILED
June 26, 1962

DECISION

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing

on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $25.00 was validly assessed and collected from the petitioner and she is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $14.78 plus interest of $1.26, or a total of $16.04, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 15, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| IDA MAGAZINE, | ) | FILED |
| | ) | June 26, 1962 |
| Petitioner, | ) | |
| vs. | ) | Docket No. 1769 |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing

on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $20.89 plus interest of $1.78 or a total of $22.67, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 11, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

ANNE GELFAND, Petitioner, vs. DISTRICT OF COLUMBIA, Respondent.

FILED
June 26, 1962

Docket No. 1770

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is, by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $18.32 was validly assessed and collected from the petitioner and that she is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $9.00 plus interest of $.77, or a total of $9.77, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 15, 1961, to date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| HERBERT M. GELFAND, | ) | FILED June 26, 1962 |
| Petitioner, | ) | |
| vs. | ) | Docket No. 1771 |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $22.16 was validly assessed and collected from the petitioner and he is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $10.24 plus interest of $.87, or a total of $11.11, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 20, 1961, to date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| MEYER GELFAND and HERBERT M. GELFAND, EXECUTORS OF THE ESTATE OF HARRY GELFAND and SARAH GELFAND, | ) | FILED June 26, 1962 |
| Petitioners, | ) | |
| vs. | ) | Docket No. 1772 |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

## DECISION

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is, by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $191.35 was validly assessed and collected from the petitioners and they are not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $105.01 plus interest of $8.93, or a total of $113.94, was erroneously assessed and collected from the petitioners; and that the petitioners are entitled to interest thereon at the rate of 4 per centum per annum from September 26, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| MEYER GELFAND, | ) | FILED |
| | ) | June 26, 1962 |
| Petitioner, | ) | |
| vs. | ) | Docket No. 1773 |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing

on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $214.31 was validly assessed and collected from the petitioner and he is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $122.88, plus interest of $1.04, or a total of $123.92, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 26, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| CECILE S. GOLDMAN, | ) | FILED June 26, 1962 |
| Petitioner, | ) | |
| vs. | ) | Docket No. 1775 |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing

on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $125.01 was validly assessed and collected from the petitioner and she is not entitled to ary refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $100.42, plus interest of $8.54, or a total of $108.96, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 15, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| ESTHER M. HANDLEMAN, | ) | FILED June 26, 1962 |
| Petitioner, | ) | |
| vs. | ) | Docket No. 1776 |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petitioner, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $10.24 plus interest of $.87, or a total of $11.11, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 14, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

EDWARD ZUPNIK, Petitioner,
vs.
DISTRICT OF COLUMBIA, Respondent.

FILED
June 26, 1962

Docket No. 1778

DECISION

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $60.84 was validly assessed and collected from the petitioner and he is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $61.08 plus interest of $5.19, or a total of $66.27, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 15, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

FANNIE ZUPNIK, )
Petitioner, )
vs. )
DISTRICT OF COLUMBIA, )
Respondent. )

FILED
June 26, 1962

Docket No. 1779

## D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $99.71 was validly assessed and collected from the petitioner and she is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $67.22 plus interest of $5.71, or a total of $72.93, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 15, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

JOSEPH J. ZUPNIK, )
Petitioner, )
vs. ) Docket No. 1780
DISTRICT OF COLUMBIA, )
Respondent. )

FILED
June 26, 1962

D E C I S I O N

This proceeding came on to be heard upon the petition filed herein; and upon consideration thereof, and of the evidence adduced at the hearing on said petition, it is by the Court this 26th day of June, 1962,

ADJUDGED AND DETERMINED, That an income tax for the calendar year 1958 in the amount of $125.02 was validly assessed and collected from the petitioner and he is not entitled to any refund thereof,

AND IT IS FURTHER ADJUDGED AND DETERMINED, That an income tax for the calendar year 1959 in the amount of $79.30 plus interest of $6.74, or a total of $86.04, was erroneously assessed and collected from the petitioner; and that the petitioner is entitled to interest thereon at the rate of 4 per centum per annum from September 15, 1961, to the date of payment of refund.

/s/ Jo. V. Morgan
Judge

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| HYMAN GOLDMAN and YETTA D. GOLDMAN, et al., | ) | FILED July 26, 1962 |
| Petitioners, | ) | Docket No. 1761, 1762, 1763, 1764, 1765, 1766, 1767, 1769, 1770, 1771, 1772, 1773, 1775, 1776, 1778, 1779, 1780. |
| v. | ) | |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent. | ) | |

PETITION FOR REVIEW OF DECISIONS OF THE DISTRICT OF COLUMBIA TAX COURT

To the Honorable Chief Judge and Circuit Judges of the United States Court of Appeals for the District of Columbia Circuit:

1. Respondent, District of Columbia, petitions for a review by the United States Court of Appeals for the District of Columbia Circuit, of decisions of the District of Columbia Tax Court made in the above-entitled cases.

2. The decisions of which review is sought reduced assessments of District of Columbia income taxes for the calendar year 1959 and in docket numbers 1762 and 1763 also reduced assessments for the calendar year 1960.

3. The decisions of the Tax Court were entered on June 26, 1962.

* * *

DISTRICT OF COLUMBIA TAX COURT

| | | |
|---|---|---|
| HYMAN GOLDMAN, et al, | ) | FILED<br>July 26, 1962 |
| Petitioners | ) | Docket Nos. 1761-67 (incl)<br>1769-73 (incl) |
| vs. | ) | 1775 & 1776 (incl)<br>1778-1780 (incl) |
| DISTRICT OF COLUMBIA, | ) | |
| Respondent | ) | |

PETITION FOR REVIEW OF A DECISION OF

THE DISTRICT OF COLUMBIA TAX COURT

To the Honorable Chief Judge and Circuit Judges of the United States Court of Appeals for the District of Columbia Circuit:

1. Hyman Goldman et al petition for review by the United States Court of Appeals for the District of Columbia Circuit, of decisions by the District of Columbia Tax Court in the above-entitled cases.

2. The decisions of which review are sought affirmed assessments of income taxes for the period ended December 31, 1959.

3. The decisions of the Tax Court were entered on June 26, 1962.

* * *

* * *

Docket Nos. 1761-67 (incl)
1769-73 (incl)
1775 & 1776 (incl)
1778 & 1780 (incl)

* * *

## DOCKET ENTRIES

| Date | Proceedings | Memorandum |
|---|---|---|
| 1961 | | |
| Nov. 15 | Petition filed - Taxpayer notified, Corporation Counsel and Finance Office served. | Income & Franchise Tax |
| Nov. 29 | Amended Petition filed - Copies served Corporation Counsel and Finance Office. | |
| Dec. 22 | Hearing set for Jan. 18, 1962 - Certificate of service. | |
| 1962 | | |
| Jan. 10 | Motion to Consolidate Cases and For Continuance of Hearing - Certificate of Service. | |
| Jan. 11 | Granted - Continued to Feb. 1, 1962 - All parties notified. | |
| Feb. 1 | Hearing held - Harrison Howes Esq., for District - Second hearing to be had Feb. 9, 1962. | |
| Feb. 9 | Second hearing - Harrison Howes, Esq. for District. | |
| Mar. 2 | Petitioner's Motion for Extension of Time to File Petitioner's Brief. | |
| Mar. 5 | Granted - Certificate of Service. | |
| Mar. 20 | Brief on Behalf of Petitioners - Certificate of Service. | |

| | |
|---|---|
| Apr. 13 | Stipulation - Respondent's Motion for Extension of Time Within Which to File Brief. |
| Apr. 16 | Granted - Certificate of Service. |
| Apr. 18 | Respondent's Brief Statement of Facts - Certificate of Service. |
| Apr. 24 | Reply Brief on Behalf of Petitioners - Certificate of Service. |
| May 8 | Findings of Fact and Opinion - Certificate of Service. |
| May 21 | Motion for Reconsideration - Certificate of Service. |
| May 24 | Motion to Set Time to File Answer to Motion for Reconsideration - Certificate of Service. |
| May 25 | Granted to June 1 - Copies served. |
| June 1 | Motion to Further Extend the Time to File Answer to Motion for Reconsideration - Certificate of Service. |
| June 4 | Answer to Petitioners' Motion for Reconsideration. Certificate of Service. |
| June 5 | Motion Granted - Certificate of Service. |
| June 11 | Amendment to the Findings of Fact and Opinion - Certificate of Service. |
| June 26 | Computation For Entries of Decision Under Rule 30. |
| June 26 | Decision - Certificate of Service. |
| July 26 | Petition For Review of Decisions of The District of Columbia Tax Court filed by Respondent - Certificate of Service. |

| | |
|---|---|
| July 26 | Petition For Review of a Decision of The District of Columbia Tax Court filed by Petitioners - Certificate of Service. |
| Aug 24 | Motion To Extend The Time For Filing Records On Appeal and Docketing Appeals - Certificate of Service. |
| Aug 27 | Granted - Certificate of Service. |
| Sept 21 | Designation of Record - Certificate of Service. |

BRIEF OF RESPONDENTS IN NO. 17,352
BRIEF OF PETITIONERS IN NO. 17,354

# United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

**No. 17,352**

DISTRICT OF COLUMBIA, *Petitioner*

v.

HYMAN GOLDMAN ET AL, *Respondents*

**No. 17,354**

HYMAN GOLDMAN ET AL, *Petitioners*

v.

DISTRICT OF COLUMBIA, *Respondent*

**On Petition for Review of Decisions of the District of Columbia Tax Court**



NATHAN SINROD
WERNER STRUPP
*Attorneys for Petitioners*
in No. 17,354 and for
Respondents in No. 17,352
1735 DeSales Street, N. W.
Washington 6, D. C.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.

## QUESTIONS PRESENTED

The questions presented by this case are as follows:

1. Whether the District of Columbia Tax Court erred in holding that, under the applicable provisions of the District of Columbia Income and Franchise Tax Act, a corporation that has sustained an operating deficit, may not use subsequent earnings to reduce such deficit, before those same earnings become available for dividend distributions in subsequent years.

2. The second question presented herein relates to that portion of the case in which Hyman Goldman et al are respondents. Such question is correctly stated in the brief filed on behalf of the District of Columbia.

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## TABLE OF STATUTES, REGULATION AND TEXTS



## TABLE OF CASES



* Cases and authorities chiefly relied on are marked by asterisks.

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# United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

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No. 17,352

DISTRICT OF COLUMBIA, *Petitioner*

v.

HYMAN GOLDMAN ET AL, *Respondents*

---

No. 17,354

HYMAN GOLDMAN ET AL, *Petitioners*

v.

DISTRICT OF COLUMBIA, *Respondent*

---

**On Petition for Review of Decisions of the District of Columbia Tax Court**

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## BRIEF OF RESPONDENTS IN NO. 17,352 BRIEF OF PETITIONERS IN NO. 17,354

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### PRELIMINARY STATEMENT

This case is before the Court as cross-appeals from decisions of the District of Columbia Tax Court. By order of the Court, the cases have been consolidated for the purpose of filing briefs. The District of Columbia has heretofore filed its brief as petitioner and this brief is filed on behalf of Hyman Goldman et al, as petitioners in No. 17,354 and as respondents in No. 17,352.

## JURISDICTIONAL STATEMENT

This action was initially brought by Hyman Goldman et al in the District of Columbia Tax Court, as appeals from deficiency assessments levied against the several petitioners by the District of Columbia.

The Tax Court held that assessments made against the taxpayers for the year 1959 were partially invalid and that the assessments made against certain of the petitioners for the year 1960 were partially invalid. (J.A. 55-72). The decisions of the Tax Court were entered on June 26, 1962. Both parties filed petitions of review of these decisions on July 26, 1962. (J.A. 73-74).

The statutory jurisdiction of this Court to review decisions of the District of Columbia Tax Court, is correctly stated in the brief of the District of Columbia and is adopted for purposes of the present brief.

## STATEMENT OF THE CASE

As pointed out in the brief filed on behalf of the District of Columbia, these cases involve assessments of income taxes for the years 1959 and 1960. The petitioners, during those years, were stockholders of four corporations, known as The Berkshire, Inc., Queenstown Apartments Section A, Inc., Queenstown Apartments Section B, Inc. and Queenstown Apartments Section E, Inc. To facilitate references to the briefs of both parties, we will refer to the various corporations in the same manner as the District of Columbia has done in its brief, i.e. "The Berkshire", "Queenstown A", "Queenstown B" and "Queenstown E".

The questions decided by the District of Columbia Tax Court relate to the taxability of distributions made by the aforesaid corporations to the various taxpayer-stockholders. Hyman Goldman et al are in accord with the Tax Court's desisions respecting distributions made by The Berkshire;

they appeal from a portion of the Tax Court's decision concerning the distributions received from the three Queenstown corporations.

The Tax Court's "Amended Findings of Fact and Opinion" reflect the pertinent portions of the fiscal history of Queenstown 'A', Queenstown 'B' and Queenstown 'E'. (J.A. 46-48). Each of these three corporations, during the year 1959, distributed funds to its stockholders. At the time of such distributions, all three corporations had incurred accumulated deficits from operating losses that occurred prior to January 1, 1959. (J.A. 46-47). During the year 1959, all three corporations distributed funds in excess of the amount of earnings for that year. (J.A. 46-47). Queenstown 'A' had net earnings in the year 1958; Queenstown 'B' had net earnings in the years 1957 and 1958 as did Queenstown 'E'. (J.A. 47-48). None of the three corporations distributed any funds to their stockholders during the years 1957 and 1958. (J.A. 46-47). The 1960 Queenstown distributions were made after those corporations had discontinued business (J.A. 44).

## COUNTERSTATEMENT OF THE CASE

These petitioners find no basis in the record for the portion of the District of Columbia's "Statement of the Case" in which it is said "The District of Columbia Tax Court found that the distributions from the 'depreciation reserves' of these four corporations were in the nature of a return of capital to the stockholders and, as such, were not subject to District income taxes". (Brief of the District of Columbia, page 2.) The phrase "return of capital" is not used by the Tax Court in any of its findings or opinions. However, the term "capital distribution" is repeatedly used by the Tax Court. (J.A. 38, 54).

There was testimony that explained how cash funds received by the owner of rental property, above and beyond

the funds required for mortgage amortization, give rise to distributions that may be in excess of a current year's earnings. (J.A. 15). The Tax Court's findings illustrate this theory in the various years before the Court. (J.A. 18-25).

Although not separately funded, the Tax Court found that the "Depreciation Reserve" carried on the corporations' books was intended to represent the accumulation of depreciation deductions by means of a bookkeeping entry (J.A. 19).

At the hearing before the Tax Court, although not contending that the distributions involved were dividends, the District of Columbia contended that they were made out of the earnings of the corporations and "probably" a dividend. (J.A. 10).

## STATUTES INVOLVED

The statutes involved are fully and accurately set forth in the brief filed on behalf of the District of Columbia, and a re-statement of them for purposes of the present brief is deemed unnecessary.

## STATEMENT OF POINTS

1. Whenever a corporation has sustained operating losses, causing its books to reflect an accumulated deficit, its subsequent earnings other than current earnings, must first be used to reduce the deficit before they become available for dividend distribution.

2. In view of the foregoing, earnings of the current year do not become enhanced by prior year's profits used to reduce a deficit, in determining the portion of a distribution that qualifies as a dividend.

## SUMMARY OF ARGUMENT

Hyman Goldman et al, as petitioners in No. 17,354 contend in their argument as follows:

1. The Tax Court erred in holding that in the case of the three Queenstown corporations, certain of their net earnings prior to 1959 which were not currently distributed, became available as dividends during 1959. This ruling does not take into account the fact that when a corporation has sustained an operating deficit, any earnings realized in later years, when not distributed during the year in which they are earned, must first be applied to a reduction of a deficit. Only when such deficit has been eliminated can these earnings and profits become the source of taxable dividends.

These petitioners submit that the Federal statutes and decisions that are referred to by the Tax Court in this connection, support the taxpayers' position. It is further submitted that a correct interpretation of the applicable District of Columbia statute, requires a conclusion that is in complete accord with the Federal precedents. Moreover, it is submitted that the portion of the District law that defines a dividend as earnings "whenever earned" by the corporation introduces no new principle into this field of taxation and lends no support to the Tax Court's ruling.

Hyman Goldman et al, as respondents in No. 17,352, contend in their argument as follows:

2. There is no basis in the statute or in the legal precedents for the position that when a corporation distributes funds in excess of current and accumulated earnings, from depreciation reserves or from other sources, that the stockholder-distributee receives anything other than a distribution of capital. It has been well-recognized that corporate distributions from depreciation reserves result in the payment to the stockholders of part of the corporation's capital. They are to be so regarded in determining

the tax consequences to the stockholders. Such transactions are to be treated in direct relation to stock ownership in the same manner as a sale or exchange of a capital asset. Under District of Columbia law, if the stock has been owned for more than two years, no gain can be realized from such distribution. There is no reason to assume that the answer to these questions will be found in an attempt to tax the receipt of such funds as being part of the general and undefined classification of "gross income". Corporate dividends and distributions are specific taxable events, involving well-established principles of finance and taxation. We submit that the Tax Court correctly applied these principles in determining the degree to which these taxpayers realized taxable income.

## ARGUMENT

### I.

**The Tax Court erred in holding that earnings not currently distributed, where there exists an accumulated deficit, became available as dividends in subsequent years.**

Reference to the record in these cases, discloses certain facts that are necessary to a consideration of this question. Each of the three Queenstown Corporations ended its operational activities during the period ended September 30, 1959. Each company during this period made distributions to stockholders, i.e. $7,783.18 for Queenstown 'A', $15,961.64 for Queenstown 'B' and $15,002.05 for Queenstown 'E'. Each corporation had earnings after taxes for the same period and such earnings were *less* than the amounts of the above-mentioned distributions. Two of the three corporations had operating profits in two of the years immediately preceding the year in question; one of the corporations had operating profits in the one immediately preceding year. All three corporations had accumulated operating deficits prior to the time the foregoing profits were earned. All of these facts are reflected in the schedules contained on pages 46 to 48 of the Joint Appendix.

A word of explanation is required respecting the earlier reference to "accumulated operating deficits". Such deficits must be distinguished from deficits that are created as a result of capital distributions. It will be noted in examining the last column of the schedules appearing on pages 46 and 47 of the Joint Appendix, that capital distributions have been disregarded in computing the cumulative deficit or as it is called there "Cumulative Net Operating Loss".

It should be emphasized here that the taxpayers do not contest the Tax Court's ruling that if capital is impaired by distributions in excess of earnings, such impairment may not be remedied by subsequent operating profits. This position is doubtlessly correct. *F. W. Henninger,* 21 B.T.A. 1234.

A completely different question is presented, however, when the deficit results from operating losses only, and then the corporation realizes new earnings.

The Tax Court, in its amended findings and opinion, fully discusses the history of the Federal Statutes and decisions (J.A. 48-52). We agree with the Tax Court that the Revenue Act of 1936 made a material change in the definition of "dividends", from those in effect under the Revenue Act of 1934 and prior laws. Under the older statutes with exceptions not pertinent, a dividend was defined as a distribution out of earnings and profits "accumulated after February 28, 1913". (J.A. 48). The later Act added a further clause which also defined a dividend as being a distribution "out of the earnings or profits of the taxable year . . . without regard to the amount of the earnings and profits at the time the distribution was made". (J.A. 49). What the later statute added was simply the proviso that if a corporation has earnings during the current year, such earnings can become the source of a taxable dividend, notwithstanding the fact that there existed an accumulated deficit at the beginning of that same year. This became the

established principle in the Federal tax field. *William G. Maguire,* 21 T.C. 853; *Stanley* v. *Waldheim,* 25 T.C. 839. These petitioners do not contest the correctness of the Tax Court's analysis of this question, up to that point. It should also be noted that to the extent that the Queenstown corporations had "current earnings" as defined above, such earnings when distributed were regarded as ordinary dividends and so reported by the taxpayers.

The addition of the above-mentioned clause to the 1936 Revenue Act placed a limitation on a principle that was well-established prior thereto. That is, a corporation that has an accumulated deficit cannot declare a dividend from subsequent profits, until that deficit has been extinguished. *Foley Securities Corporation,* 38 B.T.A. 1036, aff'd (8th Cir. 1939) 106 Fed. 2d 731. *Van Norman Co.* v. *Welch,* (1st Cir. 1944) 141 Fed. 2d 99; *Crystal Ice Co.,* 14 B.T.A. 682. See also Mertens, Law of Federal Income Taxation, Sect. 9:26. We submit that subject to the noted limitation, the mentioned principle is still sound and correct.

The Federal cases referred to by the Tax Court that interpret the post-1936 statute simply stand for the principle that *current* earnings give rise to dividends, regardless of the existence of a deficit. This much we do not contest. However, the Court below has gone beyond these rulings and has held that earnings realized in 1957 and 1958 which were not distributed, and in fact on the corporate books reduced the accumulated deficit, retain their character as earnings and can become the source of dividends in a later year.

We are not aware of any Federal decision that would support this theory. On the contrary, the approach seems to be inconsistent with the traditional concepts of dividend taxation; that is, when capital has been impaired by operating losses, the corporate board of directors should have the privilege of mitigating such impairment. If the corporate affairs in subsequent years are such as to permit

distributions in excess of earnings, there is no requirement that we can conceive of that would "relate back" to the events of the past to trace the accumulated surplus or deficit into its component parts. Once profits or losses have been added into or subtracted from a surplus account, they lose their former identities and become but an element of the financial history of the corporation that is represented in these accounts.

There remains only one further question for a resolution of this portion of the case: Does the District statute relating to the taxability of dividends lend support to the conclusion reached by the Tax Court?

We submit that an examination of the pertinent provision must lead to a negative answer to this question.

The pertinent portion of the District statute is found in Title I, Section 4(m) of the Act (47-1551c (m) D. C. Code, 1961), appearing in full on page 8 of the District's brief. Except for the fact that there is, of course, no need for a reference to the Feb. 28, 1913 date, there is no material difference between the statutory language here and the provisions of the two Federal Revenue Acts, referred to in the opinion of the Tax Court. For purposes of the present case, we submit that it is unimportant whether the District law is more similar to the 1936 Federal Act or to the earlier provisions. The only significant change by the 1936 enactment was to clarify that earnings and profits of the current year are available for ordinary dividend distribution, irrespective of the fact that there is an accumulated deficit. As has been pointed out, there is no dispute on this point and the taxpayers filed their returns in accordance with the principle of the later Federal statute.

The Tax Court found that the words "whenever earned" in the District statute provide the key to the problem. We submit that the Tax Court was in error on this point. The use of these words appears designed to establish beyond

question that only corporate earnings can give rise to dividends. This has been of great significance in the so-called "unrealized appreciation" cases in which the District has unsuccessfully urged that an increment in value of corporate property, never realized by the corporation, should be regarded as part of surplus. *District of Columbia* v. *Oppenheimer,* 112 U.S. App. D.C. 239, 301 Fed. 2d 563. Therefore, the words "whenever earned" must be read together with the following words "by the corporation" in order to perceive the full meaning of the statute. We submit that "whenever earned" is not purely a temporal concept but one that relates to the entity receiving the income.

We further submit that the distinction that the Tax Court makes between "earnings" and "profits" cannot support the conclusion reached. It is quite correct that "annual net earnings may be productive of net profits or . . . reductive of the deficit". *Lich* v. *U. S. Rubber Co.,* 39 Fed. Supp. 675. This merely means that net earnings instead of becoming available for dividends, can be utilized to reduce a pre-existing deficit. The latter method integrates the earnings into the surplus account, either by eliminating the deficit or by converting it into a surplus or positive balance. Once this has been done, the former "earnings" have been absorbed into the corporation's capital structure. In subsequent years, they may form part of an accumulated surplus account and thus give rise to dividends, but they cannot retain their former characteristic of being current earnings or "undivided profits". As the Supreme Court said in *Willcuts* v. *Milton Dairy Co.,* 275 U. S. 215, 72 L. Ed. 247, 48 S. Ct. 71:

> "But it is a prerequisite to the existence of 'undivided profits' as well as a 'surplus' that the net assets of the corporation exceed the capital stock. Hence, where the capital is impaired, profits, though earned and remaining in the business, if insufficient to offset this impairment do not constitute 'undivided profits'."

We contend that there is nothing contained in the District of Columbia statute that suggests an intended departure from the well-established rules, herein discussed.

## II.

**The District of Columbia Tax Court was correct in holding distributions from depreciation reserves, in excess of current and accumulated earnings, to be non-taxable.**

As appears from the counterstatement of the case included herein, there seems to have been considerable uncertainty in the contentions of the District, whether the distributions here in question constitute dividends, as defined in the Act, or whether they are to be regarded as undefined "gross income". Some of this uncertainty seems to have been carried over into the District's brief filed in this Court. While stating in its argument (page 16 of the brief) that the Tax Court "erroneously" believed that the sole question in this case was whether the distributions are dividends, substantial reliance is placed on the decision of this Court in *Berliner* v. *District of Columbia,* 103 U.S. App. D.C. 351, 258 Fed. 2d 651, cert. den. 357 U.S. 937, 2 L. Ed. 2d 1551, 78 S. Ct. 1384. That case was concerned with the question of whether certain liquidating distributions were from the *earnings* of the corporation. The case has no connection with any theory that corporate distributions can be taxed as "gross income" in the absence of corporate earnings and profits. Although it is conceded that the distributions here involved did not come from corporate earnings, we find the statement on page 21 of the District's brief which reads as follows:

> "In substance, there is no real distinction between the distributions to the stockholders in Berliner and the distributions to respondents here".

Seemingly then, the District adheres to the argument that the distribution may have been dividends, after all.

The facts relating to the distributions held to be nontaxable by the Tax Court are not in dispute. All of the corporations involved in these cases distributed funds to their stockholders which in part exceeded current and accumulated earnings. There is also no question that the cash thus paid to the stockholders, in excess of earnings, could be obtained from but one source, i.e. the funds accumulated from depreciation deductions to the extent that they were not required for mortgage amortization.

The question whether such distributions from depreciation reserves are dividends, is easily answered. The statute, Sec. 47-1551c(m), D. C. Code, 1961, makes it abundantly clear that a dividend has to come from corporate "earnings, profits or surplus". Enough has been said both in this brief and in the Tax Court's findings and opinions, to remove any doubt that there were no corporate earnings, profits or surplus available as a source of these payments. That distributions from depreciation reserves when exceeding earnings, cannot result in a taxable dividend is no longer in doubt in the Federal Tax field. Section 301(c) of the Internal Revenue Code of 1954; *Gross* v. *Commissioner,* (2nd Cir. 1956), 236 F. 2d 612; *John K. Beretta,* 1 T.C. 86, aff'd (5th Cir. 1944) 141 Fed. 2d 462, *Douglas Hotel Co.,* 14 T.C. 1136, aff'd (8th Cir. 1951) 190 F. 2d 766. Section 1.316-2(e) of the Federal Income Tax regulations under the 1954 Code, contains the following statement:

> "A reserve set up out of gross income by a corporation and maintained for the purpose of making good any loss of capital assets on account of depletion or depreciation is not a part of surplus out of which ordinary dividends may be paid".

No argument, other than the reference to the *Berliner* case noted above, is made by the District to urge this Court to reverse the plainly correct ruling of the Tax Court that, under the foregoing circumstances, a stockholder cannot receive a taxable ordinary dividend.

Thus, we are left with the argument that the distributions from depreciation reserves are "gross income" within the meaning of the broad definition of Section 2(a) of Title III of the Act (Section 47-1557a, D. C. Code, 1961), appearing in full on pages 8-9 of the District's brief.

There is no doubt that a broad definition of gross income, such as is contained in the above-cited section, is a common and often useful element in most taxing statutes. It has existed for many years in the Federal income tax laws and it is present in most state tax laws. This definition of gross income is obviously designed to encompass, by enumeration where possible, most of the conceivable situations that might result in taxable income. In addition, the language in such section is usually broad enough to include in the definition some of the more unusual events that lead to the receipt of income. The cases referred to by the District of Columbia illustrate this purpose of a general definition section.

The District of Columbia provision is not unlike the Federal enactment defining gross income. However, it contains the notable exception relating to "capital assets" or income "growing out of" their ownership or sale. Dividends are also specifically mentioned, and as already stated are defined elsewhere in the Act. Section 4(1) of the Act defines a "capital asset" as property, other than inventory assets, that has been held for more than two years.

We submit that the applicable statute leaves no question as to the tax status of corporate distributions. When a corporation pays money to a stockholder it can take the funds from its earnings, or in the absence of earnings, it can take the funds from capital. There is no need to resort to definitions of "gross income" to reach the meaning of such a transaction. The Congress has ordained that when a District resident has owned corporate stock for more than two years, he has acquired a capital asset which, except

for dividends, cannot produce any income for District tax purposes. There can be no doubt that the right to receive a capital distribution is based on stock ownership as, indeed, the funds representing depreciation reserves are part of the corporation's capital to which only a stockholder can be entitled. As was said by the Circuit Court in *Douglas Hotel Co., supra:*

> "It seems perfectly obvious that when the depreciation reserve fund was withdrawn by Mr. Miller, that withdrawal was not of accumulated earnings and profits but was, for all practical purposes, a withdrawal of that much of petitioner's capital assets . . ."

See also, *R. D. Merrill Company,* 4 T. C. 955.

The attempt to tax a capital distribution under the broad definition of "gross income" is not new. It was precisely this approach that the Commissioner of Internal Revenue used in the *Gross* case and was rejected there. Similarly, the State of New York argued for inclusion in "gross income" of corporate distributions exceeding earnings. In *Marx* v. *Bragalini,* 6 N.Y.S. 2d 322, 160 N.E. 2d 611 (1959) the New York Court of Appeals rejected this argument, relying primarily on the decision in the *Gross* case and further stating:

> "It has long been the policy of our Courts to adopt, whenever reasonable and practical, the Federal construction of substantially similar tax provisions".

The fact that the District statute does not specifically mention "capital distributions" presents no problem in view of the well-defined principles governing such transactions. We submit that the Tax Court was clearly correct in applying the rules of Federal income taxation to reach the answer to the questions here presented. The similarity of the provisions of law involved make resort to Federal decisions a matter of necessity. This practice has been

approved by this Court. *District of Columbia* v. *Lewis*, 109 U. S. App. D. C. 353, 288 Fed. 2d 137; *Broadcasting Publications, Inc.* v. *D. C.*, — U. S. App. D. C., — Fed. 2d — (decided Nov. 21, 1962).

It should be mentioned that repeatedly in the brief of the District of Columbia, it is stated that the Tax Court held the distributions to be a "return" of capital and that the taxpayers had recovered their cost of the stock long before. As has been pointed out, no such ruling was made by the Tax Court. Moreover, the theory of a capital distribution has no connection with the amount paid for stock, except that such cost may be deducted in computing any taxable gain. Obviously, the cost of stock can only be returned once, but a corporation can distribute *its* capital to a stockholder for so long as he remains the owner of the stock and without regard to how much he paid for it originally.

The foregoing discussion has been concerned with distributions from depreciation reserves only. In 1960, the stockholders of the Queenstown Corporations received distributions after the companies had discontinued business. There were no earnings during that period. The funds were received from reserves deposited with the mortgagees (J.A. 44). The Tax Court held that distributions from this source were from capital and non-taxable. We contend that for the reasons previously discussed with reference to distributions from depreciation reserves, this ruling was also correct.

## CONCLUSION

In view of the foregoing facts and arguments, Hyman Goldman et al respectfully submit that

1. The District of Columbia Tax Court should be reversed in its ruling that earnings from prior years became available as ordinary dividends in 1959, in addition to the actual earnings of that year, notwithstanding the existence of an accumulated operating deficit.

2. In all other respects, the decisions of the District of Columbia Tax Court should be affirmed.

Respectfully submitted,

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# BRIEF FOR DISTRICT OF COLUMBIA AS RESPONDENT IN NO. 17,354 COMBINED WITH REPLY OF DISTRICT OF COLUMBIA TO BRIEF OF HYMAN GOLDMAN, ET AL., IN NO. 17,352

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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No. 17,352

DISTRICT OF COLUMBIA,
Petitioner,
v.
HYMAN GOLDMAN, et al.,
Respondents.

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No. 17,354

HYMAN GOLDMAN, et al.,
Petitioners,
v.
DISTRICT OF COLUMBIA,
Respondent.

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ON PETITION FOR REVIEW OF DECISIONS OF
THE DISTRICT OF COLUMBIA TAX COURT

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## COUNTER-STATEMENT OF THE QUESTION PRESENTED

Where Hyman Goldman, et al., as stockholders in corporations, without there occuring any redemption of their stock interests or liquidation or dissolution of the corporations, received from such corporations cash distributions in excess of the earned surplus of the corporations, the question presented is:

Was it not error for the District of Columbia Tax Court to hold that these distributions were not includible in the gross income of respondents as defined by the District of Columbia Income and Franchise Tax Act of 1947, as amended?

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### Subject Index



### STATUTES CITED

IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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No. 17,352

DISTRICT OF COLUMBIA,

Petitioner,
v.

HYMAN GOLDMAN, et al.,

Respondents.

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No. 17,354

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# BRIEF FOR DISTRICT OF COLUMBIA AS RESPONDENT IN NO. 17,354 COMBINED WITH REPLY OF DISTRICT OF COLUMBIA TO BRIEF OF HYMAN GOLDMAN, ET AL., IN NO. 17,352

## PRELIMINARY STATEMENT

In accordance with the Order of this Court dated

February 20, 1963, this brief contains the brief of the District of Columbia as respondent in No. 17,354 combined with a reply of the District of Columbia to the brief of respondents Hyman Goldman, et al., in No. 17,352.

## COUNTER-STATEMENT OF THE CASE

The statement of the case contained in the District's brief as petitioner in No. 17,352, and the statement of the case in the brief of Hyman Goldman, et al., as petitioners in No. 17,354, set forth the necessary facts in these cases.

## SUMMARY OF ARGUMENT

The District of Columbia Tax Court was correct in its amendment to the findings of fact and opinion filed June 11, 1962, when it held that an impairment of capital resulting from an operating deficit did not have to be restored by subsequent earnings of the corporations involved before these earnings became available for dividends under the

definition of a dividend in the District of Columbia Income and Franchise Tax Act of 1947, as amended. Although the District agrees with the Tax Court's holding, so far as it goes, it is the further position of the District that excepting only a return of the original capital investment of the stockholders, both dividends and other distributions are includible as gross income under the gross income provision in the District Act.

In its brief as petitioner in No. 17,352, the District pointed out that nothing in the District Act excludes from gross income distributions such as those received by the stockholders in the four corporations involved. For this reason, the Tax Court was in error in holding that only such distributions as it characterized as dividends under the definition thereof in the District Act were subject to tax.

## ARGUMENT

In its amended findings of fact and opinion filed June 11, 1962, (J.A. 44) the District of Columbia Tax Court held that amounts distributed to the common stockholders of Queenstown A in the fiscal year ended September 30, 1959, were comprised of earnings, both current and accumulated, of the corporations. It ruled that current and

accumulated earnings of Queenstown A were in excess of the distributions made to the stockholders by Queenstown A, and that such distributions were "dividends" constituting taxable income to the stockholders under the District of Columbia Income and Franchise Tax Act of 1947, as amended.

As to distributions in the fiscal year ended September 30, 1959 by Queenstown B to its stockholders the Tax Court held that amounts totaling $14,510.66 were, similarly, dividends under the definition in the District Act and taxable to such stockholders, but that amounts totaling $1,450.98 were not dividends as defined in the District Act, were capital distributions, and were non-taxable.

The Tax Court also held that amounts totaling $14,541.58 distributed by Queenstown E to its stockholders were dividends under the definition in the District Act and taxable to such stockholders, but that $460.67 distributed was not dividends as defined in the District Act, constituted capital distributions, and was non-taxable.

As the District argues in its brief as petitioner in No. 17,352, these distributions were all includible in the gross income of the stockholders under the definition of gross income in Section 2(a) of Title III of the Income and Franchise Tax Act of 1947, as amended.

No provision is made in the Act to exclude from tax any portion of these distributions.

The Tax Court was correct in its amendment to the findings of fact and opinion, filed June 11, 1962, (J.A. 44) when it held that an impairment of capital resulting from an operating deficit did not have to be restored by subsequent earnings before these earnings became available for dividends. In its discussion of the dividend provision in the Act, it held that the term "dividend" more nearly approaches the definition of the word "dividend" in the Revenue Act of 1936 and subsequent acts than it does prior acts.

The Tax Court said:

> "* * *It will be noted that the term 'dividend' in the Revenue Act of 1936, includes the distribution to shareholders of any earnings made by the distributing corporation during the taxable year, upon which provision the opinions in the United States Tax Court turned. The District of Columbia definition includes earnings of the distributing corporation 'whenever earned'." (J.A. 52)

The District agrees with the Tax Court's reasoning so far as it goes regarding the interpretation of the District statute in relating earnings to taxable distributions. The position of the District is, however, that, for District tax purposes, "gross income" includes not only distributions out of earnings but, also, distributions from so-called

"depreciation reserves", or "capital".

In the counter-statement of the case of the brief of Hyman Goldman, et al., there is the following statement:

> "These petitioners find no basis in the record for the portion of the District of Columbia's 'Statement of the Case' in which it is said The District of Columbia Tax Court found that the distributions from the "depreciation reserves" of these four corporations were in the nature of a return of capital to the stockholders and, as such, were not subject to District income taxes.' (Brief of the District of Columbia, page 2.) The phrase 'return of capital' is not used by the Tax Court in any of its findings or opinions. However, the term 'capital distribution' is repeatedly used by the Tax Court. (J.A. 38, 54)."

The District was not in error, however, in referring to the use by the Tax Court of the words "return of capital". On page 21 of that Court's findings of fact and opinion (J.A. 35) there appears the following statement:

> "It is clear from the record that the corporation intended from its beginning to make distributions to its stockholders in part from earnings and in part as a return of capital. At the end of 1953 it had distributed to them more than $350,000, while its cumulative deficit was slightly more than $300,000, representing the excess of distributions over cumulative earnings after taxes. Apart from its historical significance, the foregoing is not here important. It should, however, be here observed, that the amortization or reduction of payments on the mortgages encumbering the Berkshire were made out of the depreciation

> reserves, which were ample for that purpose, and appropriate as well, since they must be considered as capital and the logical asset from which the capital expenditure of amortization or reduction of mortgages could be made." (Emphasis supplied)

Under the "gross income" provision in the District statute it is immaterial how the distributions to stockholders are characterized. The Tax Court characterizes by several labels portions of the distributions which it holds not subject to District tax. These labels are, "return of capital", "capital distribution", and out of "depreciation reserves". The District Act does not contain any provision which would exclude from taxable gross income distributions to stockholders except a return of their original investment in the corporation.

Hyman Goldman, et al., also state in their brief:

> "As appears from the counterstatement of the case included herein, there seems to have been considerable uncertainty in the contentions of the District, whether the distributions here in question constitute dividends, as defined in the Act, or whether they are to be regarded as undefined 'gross income'. Some of this uncertainty seems to have been carried over into the District's brief filed in this Court.* * *"

Both at the hearing of these cases in the Tax Court, and in its brief here, the District has followed a consistent position that all distributions to the stockholders of the four corporations were includible

in the gross income of petitioners. The District urged, in other words, that, even in the event the Tax Court found that portions of these distributions would not qualify as dividends under the definition of dividends in the District statute, they, nevertheless, constituted income includible in the gross income of the stockholders and, as such, were subject to tax (J.A. 8-10).

## CONCLUSION

In view of the foregoing, it is respectfully submitted that the conclusion of the Tax Court complained of by petitioners Hyman Goldman, et al., in No. 17,354 was correct and should be affirmed, but that the refunds of taxes ordered by the Tax Court, and to which the appeals of the District of Columbia in No. 17,352 are directed, should be reversed.

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PETITION FOR REHEARING EN BANC

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

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No. 17,352

---

DISTRICT OF COLUMBIA,

Petitioner,

v.

HYMAN GOLDMAN AND
YETTA D. GOLDMAN, ET AL.,

Respondents.

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ON PETITION FOR REVIEW OF A DECISION OF
THE DISTRICT OF COLUMBIA TAX COURT

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

| | | |
|---|---|---|
| DISTRICT OF COLUMBIA, Petitioner, | ) | |
| v. | ) | No. 17,352 |
| HYMAN GOLDMAN AND YETTA D. GOLDMAN, ET AL., Respondents. | ) | |

## PETITION FOR REHEARING EN BANC

Pursuant to Rule 26 of the General Rules of this Court, the District of Columbia respectfully petitions the Court for a rehearing of the above-entitled case by the entire Court sitting en banc.

On December 26, 1963 Circuit Judges Wilbur K. Miller and Danaher, constituting a majority of the division before which this case, together with case No. 17,354 entitled Hyman Goldman and Yetta D. Goldman, et al., Petitioners v. District of Columbia, Respondent, was presented, affirmed decisions of the District of Columbia Tax Court holding that amounts distributed to respondents out of depreciation reserves by corporations in which respondents were stockholders were capital distributions and nontaxable under the District of Columbia Income and Franchise Tax Act of 1947, as amended.

Circuit Judge Washington, dissenting from the conclusion of the majority, said in his dissenting opinion:

"I am of the view that the Tax Court erred in holding that the parts of the distributions in excess of the corporations' earnings and profits are not taxable. To be sure, such distributions are not taxable as 'dividends,' but I think in the circumstances here they unquestionably are taxable as income to the stockholders under the broad definition of gross income * * *in Section 47-1557a of the D.C. Code.

The stockholders invested in the stocks of the corporations to derive profit or gain. They have already in previous years had returned to them in the form of tax free distributions the amounts they invested in such stocks. Everything in excess of that investment, which they thereafter receive from the corporations—including dividends, although they are separately treated in the definition—must represent to them, and from their standpoint be, a profit flowing from their investment. It is 'gains or profits, and income' derived from an investment and hence is gross income within the statutory definition. Cf. Commissioner of Internal Revenue v. Glenshaw Glass Co., 348 U.S. 426, 429-431 (1955). There is no provision in the law which can be construed as exempting from the definition of gross income distributions by a corporation which do not qualify as dividends under the statutory definition of that term but which are in excess of the investment in the stock. I conclude that after the stockholder's investment in the corporation has been returned to him tax free, the profits on his investment are taxable as thereafter received, whether or not they be 'dividends'."

This case represents the first instance in which the nature and taxability of distributions by a corporation out of so-called "depreciation reserves" has been considered by this Court. Involving, as it does, the meaning and effect of the definition of gross income contained in Section 2

(a) of Title III of the Income and Franchise Tax Act of 1947 (Section 47-1557a, D.C. Code, 1961), the case is of particular importance in the field of District income tax. That the questions presented required extensive consideration by all of the judges of the division is demonstrated by the analysis and discussion of the matter as contained in both the majority and minority opinions. Clearly, therefore, the combination of facts, that this case is one of first impression and that there is an absence of agreement among the judges of the division, warrants a rehearing of the case by the entire Court sitting en banc.

Analysis of the majority opinion shows that it is predicated almost entirely upon a conclusion that it was not the intent of the Congress to tax distributions out of depreciation reserves. The minority opinion, on the contrary, holds that, not only is such an "intent" not manifested by the language of the statute, but that the conclusion of the majority is inconsistent with the treatment of similar distributions for Federal income tax purposes.

This Court, has from time to time, in cases involving District taxing statutes, considered comparable or analogous Federal statutes. For example, in District of Columbia v. Lewis, decided January 19, 1961, 109 U.S.App.D.C. 353, 288 F.2d 137, cert. denied 368 U.S. 818, the Court, in reaching its decision as to the meaning of the words "bona fide purchase for full consideration in money or money's worth" in the District Inheritance

Tax Statute, considered comparable language of the Internal Revenue Code. Based upon that comparison, the Court concluded that the transfer there involved was not subject to inheritance tax. Similarly, in McKimmey v. District of Columbia, 112 U.S.App.D.C. 132, 300 F.2d 724 (1962), another case involving District inheritance taxes, the Court, in its opinion, referred to language in Federal Revenue Acts paralleling that of the particular provision of the Inheritance Tax Statute there involved and, based in part upon the comparison so made, rendered its decision. Berliner v. District of Columbia, 103 U.S.App.D.C. 351, 356, 258 F.2d 651, 656, cert. denied 357 U.S. 937 (1958) to which the majority refer in their opinion, also involved a consideration by the Court of Federal income tax law as an aid in the construction and application of language in the District of Columbia Income and Franchise Tax Act of 1947.

The comparison of District income tax law with analogous provisions of Federal income tax law, as made in the dissenting opinion of Circuit Judge Washington, is entirely consistent with the approach of this Court in other cases involving tax matters. Based upon such comparisons, Circuit Judge Washington concluded that the distributions to the stockholders involved were includible in their gross income for tax purposes and subject to tax. This conclusion harmonizes, so far as Congressional intent is concerned, the District's income statute with its Federal counterpart. The majority opinion, on the other hand, disregards the similarity between the

Federal and District income tax laws insofar as each provides for taxing the distributions here involved, although, of course, the method of approach to taxation is not the same. Moreover, as Judge Washington states in his opinion, nothing in the District's statute provides for the exemption from taxation which the majority decision confers upon the taxpayers.

It is respectfully submitted, therefore, that the conclusion of Circuit Judge Washington is correct, that the conclusion of the majority is incorrect, and that these consolidated case should be reviewed by the entire Court sitting en banc.

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## CERTIFICATE OF COUNSEL

I, Henry E. Wixon, Assistant Corporation Counsel for the District of Columbia, attorney for petitioner in the above-entitled case, hereby certify that the foregoing petition is presented in good faith and not for delay.

HENRY E. WIXON
Assistant Corporation Counsel, D.C.

IN THE

# United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

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No. 17,352



DISTRICT OF COLUMBIA, *Petitioner,*

v.

HYMAN GOLDMAN AND YETTA D. GOLDMAN, ET AL,
*Respondents.*

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**On Petition of Review of Decisions of the District of Columbia Tax Court**

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## ANSWER OF RESPONDENTS TO PETITION FOR REHEARING EN BANC

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The District of Columbia has petitioned this Court for a rehearing en banc, largely on the grounds that this is the first instance in which the Court has been called upon to decide the specific question here presented.

While this is true, it should be recognized that the issue decided is one that has arisen many times in the field of taxation. To be sure, it has not arisen in any cases

involving District of Columbia income tax. However, we submit that the applicable principles are so well understood and settled and so completely in accord with the majority opinion, that a rehearing of these cases should not be granted.

Traditionally, income tax statutes contain broad "gross income" provisions which are designed to reach the various kinds of gains and profits. However, these broad statutes contain exceptions and limitations. The District of Columbia tax law, as the majority opinion points out, provides "no less than 16 specific categories" of exceptions from the definition of "gross income" (footnote 3, page 3 of the slip opinion). The exception involved in this case respecting "capital assets" is founded on the principle that income which is of the nature of *Capital*, is to be given separate treatment for tax purposes as distinguished from so-called "ordinary income". For Federal tax purposes capital gains, if the asset is held for more than six months, are taxed to the extent of one half of the amount realized. In the case of District of Columbia taxation, if the asset is held for more than two years, the gain is exempt from tax altogether.

The petitioner did not contend, nor does it appear to be the view of the dissent, that the distributions here involved are of a nature other than capital. Such distributions have been held to be from capital in consistent rulings of the Federal courts in construing distributions that exceed current or accumulated earnings. The dissenting judge emphasizes the fact that there was no "sale or exchange" of a capital asset in the instant case and that, therefore, the exception of Section 47-1557a, D. C. Code (1961) does not apply. However, the statutory exception is not so limited as it speaks of "income derived from any trade or business or sales or dealings in property, whether real or personal, other than capital assets, as defined in this subchapter . . . " It is clear, there-

fore, that income which partakes of the nature of the capital asset, falls within the exception referred to.

Federal cases mentioned in the majority opinion have plainly announced the principle that corporate distributions in excess of earnings, must be regarded as of the nature of capital. This is true whether the source of funds is mortgage proceeds as in *Commissioner of Internal Revenue* v. *Gross*, (2nd Cir. 1956) 236 F. 2nd 612, or depreciation reserves as was the case in *Douglas Hotel Co.* v. *Commissioner of Internal Revenue* (8th Cir. 1951) 190 F. 2nd 766, 775. It is interesting to note that in the *Gross* case, much like in the instant case, the Government argued, and the court rejected the theory, that capital distributions should not escape taxation because the statutory definition of gross income refers to "income from any source whatever". As the majority opinion states, it is incorrect to read that part of the law without considering those sections of the statute which exclude specific kinds of income from the definition, and thus exempt them from tax.

For the reasons herein stated, it is respectfully submitted that the majority opinion filed in this case is correct and, therefore, the petition for rehearing en banc should be denied.

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